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2001]

Comments

REGULATION FD PROVIDES FIRM FOOTING ON SELECTIVE DISCLOSURE HIGH WIRE

I. INTRODUCTION

Investment analysts perform an essential function in the securities markets by collecting, verifying and evaluating information disclosed by securities issuers.¹ Analysts collect information from a number of sources, including public securities filings, press releases and direct contact with issuer personnel.² Analysts are frequently employed to provide investment advice either exclusively or, more frequently, by investment management firms.³ In either case, the analyst's role is to discover information and make investment recommendations based upon the information revealed.⁴ In return for compensation, these recommendations are communicated to a small number of investors, who reap the information's potential benefits.⁵ In addition, multi-service investment firms regularly use the information when investing for their own accounts.⁶

Frequently, in the course of collecting and verifying investment information, analysts receive material nonpublic information from corporate insiders such as directors and officers. The disclosure may be in response to specific questions asked or may be encompassed in an official statement made to a select group of individuals.⁷ This kind of corporate communication is referred to as "selective disclosure" and is a practice the Securities

1. See *Dirks v. SEC*, 463 U.S. 646, 658 (1983) (recognizing important role that securities analysts play in investment community); Paul P. Brountas, Jr., Note, *Rule 10b-5 and Voluntary Corporate Disclosures to Securities Analysts*, 92 COLUM. L. REV. 1517, 1519-20 (1992) (same).

2. See Donald C. Langevoort, Essay, *Investment Analysts and the Law of Insider Trading*, 76 VA. L. REV. 1023, 1026 (1990) (discussing process of analysis).

3. See *id.* (describing various arrangements to provide investment advice).

4. See *id.* at 1025-26 (defining investment analyst) (citing HOUSE COMM. ON INTERSTATE AND FOREIGN COMMERCE, 95TH CONG., REPORT OF THE ADVISORY COMM. ON CORPORATE DISCLOSURE TO THE SEC 89 (1977)).

5. See *id.* at 1026 (stating group must be "small enough lest the potential trading advantage to each be lost").

6. See *id.* ("[I]ntuition suggests that information generated by such . . . firms will first find its way to the firm's own trading desks and its institutional clients, and only be filtered along to retail customers after most of the opportunity for an informational trading advantage has disappeared.").

7. See *id.* ("[Q]uestions may be raised in group meetings with analysts . . . or in face-to-face or telephone contacts between a single analyst and a company insider. The opportunity for some sort of tipping occurs in the latter setting.").

and Exchange Commission ("SEC" or "Commission") has condemned.⁸ The SEC adopted a scheme of regulations, known as Regulation FD (Fair Disclosure), to specifically address selective disclosure, regarding the practice as abusive because of the unfair advantage bestowed upon traders privy to the selectively disclosed information, and viewing its occurrence as frequent.⁹

This Comment is tailored to Regulation FD, its possible effects upon the capital markets and the relationship between issuers and analysts. Part II sets forth the judicial background regarding selective disclosure prior to Regulation FD.¹⁰ Next, Part III examines Regulation FD and its mandates.¹¹ Finally, Part IV argues that Regulation FD may increase overall market efficiency and promote fairness in the marketplace.¹²

II. BACKGROUND

A. Rule 10b-5 of the Securities Exchange Act of 1934

Rule 10b-5 of the Securities Exchange Act of 1934¹³ ("Exchange Act") prohibits trading on the basis of material nonpublic information.¹⁴ Information "is material if there is a substantial likelihood that a reasonable

8. For a discussion of the SEC's position regarding selective disclosure, see *infra* notes 150-51 and accompanying text.

9. See Selective Disclosure and Insider Trading, 64 Fed. Reg. 72,590, 72,592 n.15 (Dec. 28, 1999) (to be codified at 17 C.F.R. pts. 230, 240, 243, 249) (citing Richard Frankel, Marilyn Johnson & Douglas J. Skinner, *An Empirical Examination of Conference Calls as a Voluntary Disclosure Medium*, 37 J. ACCT. RES. 133 (1999) (finding trading volume, average trade size and stock price volatility all increased immediately after communications between issuers and analysts)); Selective Disclosure and Insider Trading, 65 Fed. Reg. 51,716, 51,717 n.11 (Aug. 24, 2000) (to be codified at 17 C.F.R. pts. 240, 243, 249) (listing cases of possible selective disclosure reported in media); Selective Disclosure and Insider Trading, 65 Fed. Reg. at 51,716 ("Regulation FD (Fair Disclosure) is a new issuer disclosure rule that addresses selective disclosure."); NATIONAL INVESTOR RELATIONS INSTITUTE, A STUDY OF CORPORATE DISCLOSURE PRACTICES, SECOND MEASUREMENT 18 (1998) (reporting that 26% of responding companies admitted to selectively disclosing information).

10. For a discussion of the judicial background behind selective disclosure, see *infra* notes 13-56 and accompanying text.

11. For an examination of Regulation FD, see *infra* notes 57-95 and accompanying text.

12. For analysis of Regulation FD's possible effects, see *infra* notes 96-164 and accompanying text.

13. Employment of Manipulative and Deceptive Devices, 17 C.F.R. § 240.10b-5 (2000).

14. See *id.* Rule 10b-5 states:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

(a) To employ any device, scheme, or artifice to defraud,

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

shareholder would consider it important in deciding how to vote.”¹⁵ For information to be material, “there must be a substantial likelihood that the disclosure of the [information] would have been viewed by the reasonable investor as having significantly altered the ‘total mix’ of information made available.”¹⁶ Information is nonpublic if it has not been disseminated in a manner making it generally available to the public.¹⁷

Although Rule 10b-5 seems to prohibit trading based on *any* material nonpublic information, Congress, the United States Supreme Court and the SEC recognize the necessary role that securities analysts play in the investment community.¹⁸ Consequently, the question has repeatedly surfaced as to what extent corporate insiders and those to whom they selec-

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

Id.

15. *TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976) (setting forth standard of materiality in proxy solicitation context).

16. *Basic Inc. v. Levinson*, 485 U.S. 224, 231 (1988) (quoting *TSC Indus.*, 426 U.S. at 449). The *Basic* Court adopted the *TSC Industries* standard of materiality for purposes of Section 10(b) and Rule 10b-5. *See id.* at 232 (adopting standard). The materiality of information regarding contingent or speculative events depends upon the court balancing the probability that the event will occur and the magnitude of the event. *See id.* (discussing balancing); *see also* General Rules and Regulations, Securities Act of 1933, 17 C.F.R. § 230.405 (2000) (defining material for purposes of Securities Act of 1933 and registration forms thereunder); General Rules and Regulations, Securities Exchange Act of 1934, 17 C.F.R. § 240.12b-2 (2000) (defining material for purposes of Securities Exchange Act of 1934).

17. *See Behrens v. Wometco Enters., Inc.*, 118 F.R.D. 534, 544 (S.D. Fla. 1988) (finding sporadic reports from Canadian affiliates to New York investment firms insufficient to make information public (citing *In Re Investors Mgmt. Co.*, 44 S.E.C. 633, 643 (1971)); *SEC v. Tex. Gulf Sulphur Co.*, 401 F.2d 833, 854 (2d Cir. 1968) (en banc)).

18. *See Chiarella v. United States*, 445 U.S. 222, 233-34 n.16 (1980) (noting Congress’ recognition that market professionals “contribute to a fair and orderly marketplace at the same time they exploit the informational advantage that comes from their possession of [nonpublic information].”). In *Dirks v. SEC*, the Court stated:

[I]nformation that the analysts obtain [by meeting with and questioning corporate officers and others who are insiders] normally may be the basis for judgments as to the market worth of a corporation’s securities. The analyst’s judgment in this respect is made available in *market* letters or otherwise to clients of the firm. It is the nature of this type of information, and indeed of the markets themselves, that such information *cannot be made simultaneously available to all of the corporation’s stockholders or the public generally.*

Dirks v. SEC, 463 U.S. 646, 658-59 (1983) (emphasis added).

In its brief to the Supreme Court in *Dirks*, the SEC conceded that “[t]he value to the entire market of [analysts’] efforts cannot be gainsaid; market efficiency in pricing is significantly enhanced by [their] initiatives to ferret out and analyze information, and thus the analyst’s work rebounds to the benefit of all investors.” *See id.* at 658 n.17 (quoting 21 S.E.C. Docket 1401, 1406). *But see* Chairman Arthur Levitt, Address at the Economic Club of New York City (Oct. 18, 1999), at <http://www.niri.org/publications/alerts/levitt101999.cfm> (discussing role of analysts in capital marketplace). Chairman Levitt stated:

tively disclose material nonpublic information can be held liable for insider trading under the federal securities laws.

B. *Rule 10b-5 Liability and the Supreme Court's Ruling in Dirks v. SEC*

When faced with the question of imposing insider trading liability in the context of selective disclosure, the United States Supreme Court in *Dirks v. SEC*¹⁹ found that “[i]mposing a duty to disclose or abstain solely because a person knowingly receives material nonpublic information from an insider and trades on it could have an inhibiting influence on the role of market analysts”²⁰ The Court went on to state that in order to establish 10b-5 liability in the context of selective disclosure, the SEC must prove: (1) the corporate insider breached a fiduciary duty to the company by making the disclosure; (2) the corporate insider received some direct or indirect personal benefit from the disclosure; and (3) the recipient of the information breached a duty to the corporation’s shareholders by trading on the basis of the information received.²¹ Again, however, the Court stressed that “[a]ll disclosures of confidential corporate information are not inconsistent with the duty insiders owe to shareholders.”²²

The first two elements of the *Dirks* test, which address the liability of a corporate insider, are seemingly related because whether or not a disclosure constitutes a breach of duty depends on the disclosure’s purpose.²³ An insider’s disclosure is improper when corporate information, intended to be used only for corporate purposes, is used for the insider’s personal advantage.²⁴ “[T]he test is whether the insider personally will benefit, directly or indirectly, from his disclosure. Absent some personal gain, there

Don’t misunderstand me, analysts serve an important role in ensuring the efficiency of our markets In a market that increasingly demands that . . . all participants add value to compete, analysts have positioned themselves well to do so. But if analysts continue to view the world through rose-colored lenses, they doom themselves to irrelevance.

Id.

19. 463 U.S. 646 (1983).

20. *Id.* at 658.

21. *See id.* at 661-64 (listing elements of offense). The third element applies only to recipients of information, and consequently is not necessary to establish a corporate insider’s liability. *See id.* For a discussion of the two ways that a corporate outsider may acquire a duty to the corporation’s shareholders, see *infra* notes 30-35 and accompanying text.

22. *Dirks*, 463 U.S. at 661-62. For instance, a corporate insider or a recipient analyst may not know whether the information is material, or may mistakenly think that the information has already been disclosed to the market. *See id.* at 662 (stating “[i]n some situations, the insider will act consistently with his fiduciary duty to shareholders, and yet release of the information may affect the market”).

23. *See id.* at 662 (“Whether disclosure is a breach of duty therefore depends in large part on the purpose of the disclosure.”).

24. *See id.* at 663 (rejecting SEC’s argument that having to establish improper purpose would impede enforcement because “it would be a rare situation when the parties could not fabricate some ostensibly legitimate business justification for transmitting the information”).

has been no breach of duty to [the] stockholders.”²⁵ This test requires courts to focus on objective criteria, such as whether the insider received a “pecuniary gain or a reputational benefit that will translate into future earnings.”²⁶ Nevertheless, the *Dirks* Court noted that certain relationships can create an inference of improper purpose.²⁷

Next, consider the possible liability of the information’s recipient.²⁸ In order to violate Rule 10b-5, an analyst or another securities professional must owe a duty to the corporation’s shareholders.²⁹ Under *Dirks*, there are two ways that a duty to disclose or abstain from trading can be imposed upon an individual receiving material nonpublic information: (1) the recipient trades on information known to have been provided in breach of a duty or (2) the recipient’s confidential relationship with the company imposes upon the individual a duty that is breached by the subsequent

25. *Id.* at 662. “The elements of fiduciary duty and exploitation of nonpublic information also exist when an insider makes a gift of confidential information to a trading relative or friend.” *Id.* at 664.

26. *Id.* at 663. The SEC has focused on the “reputational benefit” language in *Dirks* to allege 10b-5 violations in the context of selective disclosures. *See, e.g.*, Plaintiff’s Complaint, SEC v. Stevens, Litigation Release No. 12813, 1991 SEC LEXIS 451 (Mar. 19, 1991) (91 Civ. 1869). For a discussion of the *Stevens* complaint, see *infra* notes 46-52 and accompanying text.

27. *See Dirks*, 463 U.S. at 664 (observing “there may be a relationship between the insider and the recipient that suggests a *quid pro quo* from the latter”).

28. This discussion will be limited to analysts’ liability under *Dirks* alone. Note, however, that in the context of a tender offer, analyst liability can be established under Rule 14-e as well. During a tender offer, there are a fairly large number of people who receive confidential nonpublic information but owe no duty to the issuer’s shareholders and may consequently be tempted to engage in insider trading. *See SEC v. Peters*, 978 F.2d 1162, 1167 (10th Cir. 1992) (discussing circumstances of tender offers). Furthermore, while the SEC may be able to circumstantially prove the individual was knowingly trading on inside information, it would be exceedingly difficult to prove the outsider obtained the information in breach of a fiduciary duty. *See id.* (noting same). Consequently, “Congress gave the SEC broad . . . power to ‘define, and prescribe means reasonably designed to prevent, such acts and practices as are fraudulent, deceptive, or manipulative.’” *Id.* (quoting 15 U.S.C. § 78n(e) (2000)).

Exercising this granted authority, the SEC adopted Rule 14-e. An individual violates Rule 14-e if the individual trades on the basis of material nonpublic information concerning a tender offer that he or she knows or has reason to know has been acquired directly or indirectly from an insider of the offeror or issuer, or someone working on their behalf. *See id.* (discussing 17 C.F.R. § 240.14e-3(a) (2000)). Rule 14-e eases the SEC’s evidentiary burden by eliminating the need to prove a breach of fiduciary duty. *See id.* (same). “The ‘breach of a duty’ analysis adopted by the Supreme Court in *Chiarella* and *Dirks* under Rule 10b-5 does not apply to Rule 14e-3.” SEC v. Wang, Litigation Release No. 11780, 1988 SEC LEXIS 1364, at *58 (June 27, 1988). Consequently, in the context of a tender offer, analysts and other market professionals could violate Rule 14-e even though their actions would not subject them to liability under *Dirks*.

29. *See United States v. Chestman*, 947 F.2d 551, 564-66 (2d Cir. 1991) (en banc) (discussing *Dirks* and *Chiarella*, stating “a fiduciary duty does not run . . . solely as a result of one’s possession of material nonpublic information”); *see also Dirks*, 463 U.S. at 665 (declining to decide whether *Dirks* acquired fiduciary duty to corporation’s shareholders by virtue of his position as employee of broker-dealer).

trade.³⁰ First, an analyst could violate Rule 10b-5 if the analyst trades on material nonpublic information that the analyst knows or has reason to know is supplied in breach of the corporate insider's duty to the corporation.³¹ As the Court in *Dirks* explained:

[T]he tippee's duty to disclose or abstain is derivative from that of the insider's duty

Thus, a tippee assumes a fiduciary duty to the shareholders of a corporation not to trade on material nonpublic information only when the insider has breached his fiduciary duty to the shareholders by disclosing the information to the tippee and the tippee knows or should know that there has been a breach.³²

Second, the confidential nature of the recipient's relationship with the company may transform the recipient into a "temporary insider," thereby imposing a duty to disclose or abstain from trading upon the recipient.³³ A fiduciary duty, however, cannot be unilaterally imposed simply by entrusting a person with confidential information.³⁴ Objective

30. See *Dirks*, 463 U.S. at 655, 660 (explaining facts creating duty to disclose or abstain).

31. See *id.* at 659-60 (setting forth rule).

32. *Id.* The *Dirks* "knowledge of breach" requirement has been construed to require: (1) knowledge of the tipper's breach and (2) knowledge of the personal benefit. See, e.g., *State Teachers Ret. Bd. v. Fluor Corp.*, 592 F. Supp. 592, 595 (S.D.N.Y. 1984) ("It is recognized that this reading of *Dirks* permits the possibility . . . that an improperly motivated tipper may pass information to a tippee who lacks knowledge of the tipper's personal benefit and who may therefore trade on inside information without liability."). Regulation FD obviates the requirement that the SEC show any personal benefit or knowledge thereof. See General Rule Regarding Selective Disclosure, 17 C.F.R. § 243.100 (2000) (stating general rule).

33. See *Dirks*, 463 U.S. at 655 (discussing circumstances creating "temporary insider"). In a frequently cited footnote, the Court in *Dirks* acknowledged that under certain circumstances outsiders may become fiduciaries of the shareholders: "[W]here corporate information is revealed legitimately to an underwriter, accountant, lawyer, or consultant . . . [t]he basis for recognizing this fiduciary duty is . . . that they have entered into a special confidential relationship in the conduct of the business of the enterprise and are given access to information solely for corporate purposes." *Id.* at 655 n.14. For examples of cases citing footnote fourteen of *Dirks*, see *SEC v. Ingram*, 694 F. Supp. 1437, 1439-40 (C.D. Cal. 1988); *United States v. Winans*, 612 F. Supp. 827, 841 (S.D.N.Y. 1985), *aff'd in part, rev'd in part sub nom.*, *United States v. Carpenter*, 791 F.2d 1024 (2d Cir. N.Y. 1986); *SEC v. Musella*, 578 F. Supp. 425, 436 (S.D.N.Y. 1984).

34. See *Walton v. Morgan Stanley & Co.*, 623 F.2d 796, 799 (2d Cir. 1980) (finding duty cannot be created unilaterally). *Walton* concerned the actions of an investment bank, Morgan Stanley. See *id.* at 797-98 (stating facts). While investigating possible takeover targets for one of its clients, Morgan Stanley obtained unpublished material information (internal earnings reports) on a confidential basis from a prospective target, Olinkraft. See *id.* at 797. After its client abandoned the planned takeover, Morgan Stanley used the information to trade Olinkraft stock. See *id.* In rejecting the argument that Morgan Stanley owed a duty to the Olinkraft shareholders, the court noted, "Put bluntly, although . . . Olinkraft's management placed its confidence in Morgan Stanley not to disclose the information, Morgan Stanley owed no duty to observe that confidence." *Id.* at 799.

factors indicating a confidential relationship must be present to create the outsider's duty.³⁵

The facts of *Dirks* illustrate the Court's analysis. Raymond Dirks was a securities analyst who received information from a former officer of Equity Funding of America about serious financial irregularities at the company, which resulted in materially overstated earnings.³⁶ Dirks investigated the allegations, and certain Equity Funding employees corroborated the allegations of fraud.³⁷ Dirks then discussed the information with various clients and investors, some of whom were able to avoid substantial losses by liquidating their interests in the company.³⁸ In finding that Dirks had not aided and abetted a violation of the laws against insider trading, the Court stated:

It is clear that neither [the former Equity Funding officer] nor the other Equity Funding employees violated their . . . duty to the corporation's shareholders by providing information to Dirks. The tippers received no monetary or personal benefit for revealing Equity Funding's secrets, nor was their purpose to make a gift of valuable information to Dirks. As the facts of this case clearly indicate, the tippers were motivated by a desire to expose the fraud.³⁹

Because the Court found that the former officer of Equity Funding did not breach his fiduciary duty in disclosing the information to Dirks, there was no derivative duty imposed upon Dirks to disclose or refrain from trading on the information.⁴⁰

Other courts, however, have found the personal benefit needed to establish a Rule 10b-5 violation. For example, the defendant in *SEC v. Gaspar*,⁴¹ was an oil industry analyst and director of an investment banking firm.⁴² Gaspar revealed confidential information to a broker friend regarding an upcoming tender offer.⁴³ The United States District Court for the Southern District of New York found that Gaspar had received a

35. See *Dirks*, 463 U.S. at 655 n.14 (“[T]he relationship at least must imply such a duty.”); see also *SEC v. Lund*, 570 F. Supp. 1397, 1403 (C.D. Cal. 1983) (finding “temporary insider” where recipient received confidential information only for corporate purposes).

36. See *Dirks*, 463 U.S. at 648-49 (stating facts). Interestingly, the SEC did not charge the corporate insider with any wrongdoing. See *id.* at 666 n.27 (concluding that insider received no direct or indirect personal benefit from disclosure).

37. See *id.* at 649.

38. See *id.*

39. *Id.* at 666-67 (footnote omitted).

40. See *id.* at 662 (“Absent some personal gain, there has been no breach of duty to stockholders. And absent a breach by the insider, there is no derivative breach.”).

41. No. 83 Civ. 3037, 1985 U.S. Dist. LEXIS 20698 (S.D.N.Y. Apr. 16, 1985).

42. See *id.* at *1-24 (stating undisputed facts of case).

43. See *id.* at *27-28 (stating findings of fact).

reputational benefit by revealing the information because the disclosure enhanced the parties' professional relationship, as well as their existing social relationship.⁴⁴

C. *Selective Disclosure and the Stevens Complaint*

After the SEC lost in *Dirks*, it appeared as if corporate communications with analysts enjoyed a special status.⁴⁵ However, in *SEC v. Stevens*,⁴⁶ the SEC again attacked the issue of selective disclosure. Stevens was the CEO and chairman of Ultrasystems Corporation.⁴⁷ In 1984, securities analysts criticized Stevens after the release of unexpectedly poor earnings.⁴⁸ Three years later, when Stevens learned that quarterly earnings were going to be lower than expected, he selectively disclosed that information to several analysts one day before a public announcement.⁴⁹ The analysts' clients were able to sell their shares and avoid over \$126,000 in losses.⁵⁰ Focusing on the "reputational benefit" language of *Dirks*, the SEC alleged that Stevens revealed the information in order to protect and enhance his reputation with the analysts—a reputation which the SEC al-

44. See *id.* at *44 (finding requisite personal benefit under *Dirks*). The court found that "[a]side from being friends, there existed a professional relationship between Gaspar and Schreck . . . [Gaspar] depended in part on a constant exchange of information with Schreck, from whom he also solicited professional opinions. Gaspar's disclosures to Schreck continued and enhanced that professional relationship." *Id.*

Gaspar can likely be distinguished from routine selective disclosure—for example, intentional release of expected earnings to a discrete group of analysts—because the defendant in *Gaspar*, without authorization, disclosed information that he knew was intended to be kept confidential. Although the *Gaspar* court applied the *Dirks* analysis, the situation presented in *Gaspar* lends itself more to analysis under the misappropriation theory. See, e.g., generally *United States v. O'Hagan*, 521 U.S. 642 (1997) (setting forth misappropriation theory and reviewing prior case law to find misappropriation theory consistent with § 10(b) and precedent); see also, e.g., *Duties of Trust or Confidence in Misappropriation Insider Trading Cases*, 17 C.F.R. § 240.10b5-2 (2000) (setting forth circumstances in which person has duty of trust or confidence for purposes of misappropriation theory). But see *SEC v. Rubin*, No. 91 Civ. 6531, 1993 U.S. Dist. LEXIS 13,301, at *12-13 (S.D.N.Y. Sept. 23, 1993) ("The relationship here of customer and broker was sufficient itself to create the inference of an intent to benefit . . ."); *In re Wentz*, No. 3-6180, 1984 SEC LEXIS 2607, at *31-32 (May 15, 1984) (accepting position that tip made by one of corporation's directors, who was also corporation's primary shareholder, would satisfy *Dirks* personal benefit requirement when made with expectation that corporation's stock price would increase).

45. See, e.g., *Brountas*, *supra* note 1, at 1529 (stating *Dirks* personal benefit test insulated corporate insiders from liability); *id.* (stating *Dirks* "'contains a virtual paean to the analysts'" (citing John C. Coffee, Jr., *The SEC and the Securities Analysts*, N.Y. L.J., May 30, 1991, at 5, 5) (quoting LOUIS LOSS, *FUNDAMENTALS OF SECURITIES REGULATION* 769 (2d ed. 1988))).

46. Litigation Release No. 12813, 1991 SEC LEXIS 451 (Mar. 19, 1991).

47. See *id.* at *1 (stating facts).

48. See *id.* at *2.

49. See *id.* at *2-3.

50. See *id.* at *1-2.

leged Stevens perceived as injured due to the prior criticism.⁵¹ Retired by the time the SEC brought suit in 1991, Stevens chose not to litigate the issues and entered into an immediate consent decree under which he agreed to disgorge \$126,455.⁵²

In conclusion, the SEC's approach to selective disclosure has evolved from being lenient to becoming very active.⁵³ Under *Dirks*, the SEC is required to show: that (1) the disclosure constituted a breach of the corporate insider's duty to the corporation;⁵⁴ (2) the corporate insider received a direct or indirect benefit by making the disclosure;⁵⁵ and, finally, to impose liability upon the recipient of information, (3) the recipient

51. See *id.* at *1-3 ("The [SEC's] [c]omplaint alleges that Stevens perceived this challenge as injurious to his professional reputation and as placing in jeopardy his continued earnings power as a chief executive and a manager [The selective disclosure] was seen by Stevens as having direct, tangible benefit to his status as a corporate manager.").

52. See *id.* at *1-2 (noting disgorgement "represent[ed] the amount of losses avoided by those shareholders who received material nonpublic information . . . and who sold . . . stock prior to the public announcement . . ."). Consequently, selective disclosure again became a precarious activity for insiders to engage, especially in light of the SEC's ability to impose administrative sanctions. See, e.g., The Securities Enforcement Remedies and Penny Stock Reform Act of 1990, 15 U.S.C. § 78a (1990) (giving SEC administrative authority to "cease and desist" and to administratively impose civil penalties under § 21b of 1934 Act); see also 15 U.S.C. § 77g (2000) (SEC can threaten corporate official with disbarment from service as officer or director of public company, as well as treble damages and disgorgement).

53. See *Dirks v. SEC*, 463 U.S. 646, 664 fn.24 (1983) (describing SEC's approach to policing corporate insiders (citing Speech of Homer Budge of the New York Regional Group of the American Society of Corporate Secretaries, Inc. (Nov. 18, 1965)). Homer Budge stated:

Turning to the realm of possible defendants in the present and potential civil actions, the Commission certainly does not contemplate suing every person who may have come across inside information [T]he Commission in future cases normally should not join rank and file employees or persons outside the company *such as analysts or reporters* who learn of inside information.

Id. (emphasis added).

Less than a decade later, the Commission's position had changed dramatically. See, e.g., Commissioner Edward H. Fleischman, Remarks at the University of California, San Diego, Eighteenth Annual Securities Regulation Institute (Jan. 24, 1991), in Edward H. Fleischman, *Ferretting in the Interstices of SEC Attitudes to Securities Analysts*, 2 J. CORP. DISCLOSURE & CONFIDENTIALITY 189 (1991) ("The fact is that the SEC does not accept *Dirks* [T]he SEC does not only want to keep company-to-analyst contacts in the status of 'a fencing match conducted on a tightrope' . . . it's trying hard to electrify the tightrope." (quoting *SEC v. Bausch & Lomb, Inc.*, 565 F.2d 8, 9 (2d Cir. 1977))).

54. For a discussion of what constitutes a breach of a corporate insider's duty to the corporation, see *supra* notes 21-27 and accompanying text.

55. For a discussion of direct and indirect benefits, see *supra* notes 21-27 and accompanying text.

breached a derivative duty to the corporation's shareholders by trading on the disclosed information.⁵⁶

III. REGULATION FD: A SUMMARY AND COMPARISON TO PROPOSED REGULATION FD

Again, Regulation FD constitutes the SEC's attempt to police the practice of corporate insiders selectively disclosing material nonpublic information to privileged members of the Securities Industry. This Part takes a closer look at Regulation FD and the process it prescribes.

A. *Conditions to Applicability*

1. *Which Issuers Are Subject to Regulation FD?*

To be subject to Regulation FD, an issuer must either have securities registered under Section 12 of the Exchange Act or must be required to file reports under Section 15(d) of the Exchange Act.⁵⁷ This includes closed-end investment companies, but excludes all other investment companies, foreign governments and foreign private issuers.⁵⁸

2. *Who Is Making the Disclosure?*

Regulation FD applies only to disclosures that are made by an issuer or a person acting on the issuer's behalf.⁵⁹ Under the regulations, a person "acting on behalf of an issuer" is defined as either: (1) "any senior official of the issuer"⁶⁰ or (2) "any other officer, employee, or agent of an

56. For a discussion of derivative duties, see *supra* notes 29-35 and accompanying text. Furthermore, as discussed *supra* note 28, even if the outsider's actions comport with the requirements of *Dirks*, an analyst or other corporate outsider could be found liable for insider trading under Rule 14-e.

57. See 17 C.F.R. § 243.101(b) (defining "issuer" for purposes of Regulation FD).

58. See *id.* But see *Schoenbaum v. Firstbrook*, 405 F.2d 200, 208 (2d Cir.) (finding foreign issuers remain liable for conduct that violates and meets jurisdictional requirements of federal securities laws), *rev'd on other grounds*, 405 F.2d 215 (2d Cir. 1968).

59. See 17 C.F.R. § 243.100(a) (2000) (setting forth individuals subject to Regulation FD's disclosure regime).

60. 17 C.F.R. § 243.101(c). Rule 101(f) defines "senior official" as "any director, executive officer, . . . investor relations, public relations officers, or any other person with similar functions." 17 C.F.R. § 243.101(f). Regarding closed-end investment companies, emphasis is placed on senior officials of the issuer's investment advisor. See 17 C.F.R. § 243.101(c) (emphasizing senior officials).

issuer who regularly communicates”⁶¹ with brokers,⁶² dealers,⁶³ investment advisors,⁶⁴ investment companies⁶⁵ or “holders of the issuer’s securities.”⁶⁶ The rule is addressed only to employees whose job responsibilities include interactions with securities professionals and securities holders, and is not intended to include communications made in the ordinary course of business—namely, information exchanged between a manufacturer and wholesaler.⁶⁷ To arrive at this definition, the Pro-

61. 17 C.F.R. § 243.101(c). The regulation expressly states that “[a]n officer, director, employee, or agent of an issuer who discloses material nonpublic information in breach of a duty of trust or confidence to the issuer shall not be considered to be acting on behalf of the issuer.” 17 C.F.R. § 243.101(c). Consequently, Regulation FD is not applicable to disclosures made by insiders who satisfy the first prong of the *Dirks* test—those receiving a “personal benefit.” However, such disclosures are subject to the rules regarding insider trading, including the prohibitions upon use of misappropriated information. *See, e.g.*, 15 U.S.C. § 78t-1, § 78u-1 (1994) (providing liability to contemporaneous traders for insider trading and civil penalties for insider trading). *See generally* United States v. O’Hagan, 521 U.S. 642, 660-66 (1997) (setting forth misappropriation theory). For discussion of the *Dirks* test, see *supra* notes 19-40 and accompanying text.

62. *See* 17 C.F.R. § 243.100(b)(1)(i) (referencing 15 U.S.C. § 78c). “Broker” includes “any person engaged in the business of effecting transactions in securities for the account of others, but does not include a bank.” 15 U.S.C. § 78c(a)(4) (1994).

63. *See* 17 C.F.R. § 243.100(b)(1)(i) (referencing 15 U.S.C. § 78c (1994)). A dealer is:

[A]ny person engaged in the business of buying and selling securities for his own account, through a broker or otherwise, but does not include a bank, or any person insofar as he buys or sells securities for his own account, either individually or in some fiduciary capacity, but not as a part of a regular business.

15 U.S.C. § 78c(a)(5).

64. *See* 17 C.F.R. § 243.100(b)(1)(ii) (referencing 15 U.S.C. § 80b-2(a)(11)). The definition of investment advisors includes: (1) investment advisors as defined in Section 202(a)(11) of the Investment Advisers Act of 1940, (2) institutional investment managers, as defined in Section 13(f)(5) of the 1934 Act, that filed a report on Form 13F for the most recent quarter ending prior to the date of the disclosure, or (3) any persons associated with any of the above. *See* 15 U.S.C. § 80b-2(a)(11) (1994) (defining term); 15 U.S.C. § 78m(f)(5)(A) (1994) (same).

65. *See* 17 C.F.R. § 243.100(b)(1)(iii) (referencing 15 U.S.C. § 80a-3(c)(7) (1994)). The term “investment companies” includes: (1) investment companies as defined in Section 3 of the Investment Company Act of 1940, (2) companies that would be an investment company but for Section 3(c)(1) or Section 3(c)(7) thereof, or (3) an affiliated person of any of the above. *See* 15 U.S.C. § 80a-3 (defining term). For a definition of “affiliated person,” see 15 U.S.C. § 80a-2(a)(3)(C)-(F).

66. 17 C.F.R. § 243.101(c).

67. *See* Selective Disclosure and Insider Trading, 65 Fed. Reg. at 51,720 (Aug. 24, 2000) (setting forth example of analyst quizzing store manager and stating that any disclosure “ordinarily would not trigger any Regulation FD obligations”). Note, however, that corporate insiders cannot sidestep their obligations under Regulation FD by directing a non-covered employee to make the selective disclosure. *See id.* (“[T]o the extent that another employee had been *directed* to make a selective disclosure by a member of senior management, that member . . . would be responsible for having made the selective disclosure.”).

posed Regulation FD was “modified slightly” to “make it more precise.”⁶⁸

3. *What Is the Content of the Disclosure?*

The applicability of Regulation FD’s mandates depends not only on who makes the disclosure, but also on what type of information is disclosed.⁶⁹ Regulation FD’s obligations attach only to communications of material nonpublic information about the issuer or its securities.⁷⁰ The use of a materiality standard in Proposed Regulation FD prompted conflicting comments.⁷¹ The Commission rejected the suggestion of includ-

68. *Id.* (stating proposed rule included any employee and noting adverse comments received); *see also* E-mail from Stanley Keller, Chair, Committee on Federal Regulation of Securities, Section of Business Law of the American Bar Association et al., to Jonathan G. Katz, Secretary, SEC (May 8, 2000), at <http://www.sec.gov/rules/proposed/s73199/keller2.htm> [hereinafter American Bar Association E-mail] (“Unauthorized communications of material, nonpublic information by lower-level employees typically should not bring the company within the ambit of Regulation FD.”); E-mail from Richard M. Starr, Chair, and Gregory H. Mathews, Vice Chair, Corporate and Securities Law Committee of the American Corporate Counsel Association, to Jonathan G. Katz, Secretary, SEC (Apr. 27, 2000), at <http://www.sec.gov/reules/proposed/s73199/starr1.htm> [hereinafter Corporate Counsel E-mail] (“[T]he proposed definition . . . seems unduly vague and imprecise.”).

69. For a discussion of whom Regulation FD is designed to regulate, see *supra* notes 59-68 and accompanying text.

70. *See* General Rule Regarding Selective Disclosure, 17 C.F.R. § 243.100; Selective Disclosure and Insider Trading, 65 Fed. Reg. at 51,721 (“The final regulation, like the proposal, applies to disclosures of ‘material nonpublic’ information about the issuer or its securities.”). Consequently, the Commission stressed, Regulation FD would not apply to communications of immaterial information made to an analyst who, “through some combination of persistence, knowledge, and insight,” creates a “mosaic” of information that, when combined, is material. *See* 65 Fed. Reg. at 51,722 (discussing communications outside of Regulation FD). Regulation FD, however, does not set forth statutory definitions of material or nonpublic, instead opting to rely on definitions crafted through case law. *See id.* at 51,721. For a further discussion of case law defining material and nonpublic, see *supra* notes 15-17 and accompanying text.

71. *Compare* E-mail from Philip D. Ameen, Chairman, Committee on Corporate Reporting, Financial Executive Institute, to Jonathan G. Katz, Secretary, SEC (Apr. 24, 2000), at <http://www.sec.gov/rules/proposed/s73199/ameen1.htm> (“We . . . support the [r]elease’s approach to rely on existing standards for the term ‘material nonpublic information.’ Materiality is inevitably a judgment call We do not believe [a] definition beyond what is already in the release would change this circumstance.”), and E-mail from Bradley W. Skolnik, President, North American Securities Administrators Association (“NASAA”), to Jonathan G. Katz, Secretary, SEC (Apr. 28, 2000), at <http://www.sec.gov/rules/proposed/s73199/skolnik1.htm> (“An attempt by the Commission to define ‘materiality’ . . . could have broader implications.”), with E-mail from Cleary, Gottlieb, Steen & Hamilton, to Jonathan G. Katz, Secretary, SEC (Apr. 28, 2000), at <http://www.sec.gov/rules/proposed/s73199/cleary1.htm> [hereinafter Cleary E-mail] (“[I]t is not good policy to require issuers to make materiality judgments in connection with these kinds of communications”), and American Bar Association E-mail, *supra* note 68 (“[Materiality] is a difficult, subjective analysis . . . even more difficult when made on a real time basis The combined impact . . . will be to discourage communication.”). To address concerns of discouraging communication and increasing liti-

ing a bright line standard, but, in response to requests for more interpretive guidance, set forth a list of the types of information it believes are especially likely to be considered "material."⁷² In addition, Regulation FD's requirement of "intentional" conduct also applies to the determination of materiality.⁷³

4. *Who Was the Disclosure's Recipient?*

As proposed, Regulation FD applied to disclosures of material non-public information to "any other person outside the issuer."⁷⁴ Many commenters found the scope of the proposed rule too broad and several

gation, the SEC included a number of suggestions in Proposed Regulation FD. *See* Selective Disclosure and Insider Trading, 64 Fed. Reg. 72,590, 72,595-96 (Dec. 28, 1999) (listing suggestions). They included: (1) limiting the number of persons authorized to make disclosures or field inquiries; (2) keeping a record of all communications made; (3) declining to respond to inquiries that raise questions of materiality until corporate insiders can consult with counsel; (4) securing agreements from analysts to abstain from using any information disclosed until the issuer can determine the communications' materiality; and (5) capitalizing on Regulation FD's treatment of unintentional communications. *See id.*

72. *See* Selective Disclosure and Insider Trading, 65 Fed. Reg. at 51,721 (declining to adopt bright line test). The Commission stated:

A bright-line rule indeed is easier to follow than a standard that requires the exercise of judgment in the light of all the circumstances. But ease of application alone is not an excuse for ignoring the purposes of the securities acts and Congress' policy decisions. Any approach that designates a single fact or occurrence as always determinative of an inherently fact-specific finding such as materiality, must necessarily be over or underinclusive.

Id. (quoting *Basic Inc. v. Levinson*, 485 U.S. 224, 236 (1988)). The Commission listed a wide variety of possible material information. *See id.* The list includes:

(1) Earnings information; (2) mergers, acquisitions, tender offers, joint ventures, or changes in assets; (3) new products or discoveries, or developments regarding customers or suppliers (e.g., the acquisition or loss of a contract); (4) changes in control or in management; (5) change in auditors or auditor notification that the issuer may no longer rely on an auditor's audit report; (6) events regarding the issuer's securities—e.g., defaults on senior securities, calls of securities for redemption, repurchase plans, stock splits or changes in dividends, changes to the rights of security holders, public or private sales of additional securities; and (7) bankruptcies or receiverships.

Id. The listing demonstrates some types of material that may require more scrutiny, but it is not meant to be exhaustive. *See id.* (noting that complete listing is not possible). However, the SEC did emphasize that communications with analysts regarding earnings forecasts assume a "high degree of risk" and will likely violate Regulation FD. *See id.*

73. *See* Selective Disclosure and Insider Trading, 65 Fed. Reg. at 51,722 ("As commenters suggested, this aspect of the regulation provides additional protection that issuers need not fear being second-guessed by the Commission in enforcement actions for mistaken judgments about materiality in close cases."). For discussion of what constitutes "intentional" conduct under Regulation FD, see *infra* notes 82-86 and accompanying text.

74. *See* Selective Disclosure and Insider Trading, 64 Fed. Reg. at 72,594 (describing Proposed Regulation FD).

offered alternative methods for defining the class of recipients subject to Regulation FD.⁷⁵ The Commission was persuaded by the comments received, and narrowed Regulation FD's scope to include only disclosures to the categories of person listed in Rule 100(b)(1).⁷⁶

Furthermore, Rule 100(b)(2) provides four exceptions from coverage.⁷⁷ First, Regulation FD does not apply to disclosures made to those

75. See, e.g., American Bar Association E-mail, *supra* note 68 (“[I]ssuers will face an unacceptable burden in conducting their ordinary business communications while they attempt to comply with proposed Regulation FD. This result probably was not intended by the Commission, but the rule as proposed provides no exclusion for such business communications.”); E-mail from Margaret M. Foran, Chairman, Securities Law Committee and James W. Guedry, Chairman, Selective Disclosure Subcommittee, American Society of Corporate Secretaries, to Jonathan G. Katz, Secretary, SEC (Apr. 28, 2000), at <http://www.sec.gov/rules/proposed/s73199/foran1.htm> [hereinafter Corporate Secretaries E-mail] (“We would like the regulation narrowed . . .”).

Commenters suggested a wide variety of recipient exemptions. See, e.g., E-mail from Peter G. Skinner, Executive Vice President and General Counsel, Dow Jones & Company, Inc., to Jonathan G. Katz, Secretary, SEC (Apr. 28, 2000), at <http://www.sec.gov/rules/proposed/s73199/skinner1.htm> (proffering “bona fide news organizations” exemption); E-mail from Vickie A. Tillman, Executive Vice President and Chief Rating Officer, Standard and Poor’s Ratings Services, to Jonathan G. Katz, Secretary, SEC (Apr. 17, 2000), at <http://www.sec.gov/rules/proposed/s73199/tillman1.htm> (suggesting exclusion for information received in process of securities rating); see also Corporate Secretaries E-mail, *supra* (submitting that Regulation FD be limited to “discussions by persons who regularly communicate with the investing public to non-issuer personnel who regularly make or might reasonably be expected to make investment decisions involving the issuer’s securities”).

76. See Selective Disclosure and Insider Trading, 65 Fed. Reg. at 51,719 (acknowledging that “these comments have merit”); 17 C.F.R. § 243.100 (2000) (listing categories of recipients subject to rule and excluding, among others, disclosures made “[t]o an entity whose primary business is the issuance of credit ratings, provided the information is disclosed solely for the purpose of developing a credit rating”); see also Selective Disclosure and Insider Trading, 65 Fed. Reg. at 51,720 n.27 (discussing basis for non-inclusion of certain categories). The SEC explained that “Rule 100(b)(1) will cover the types of persons most likely to be the recipients of improper selective disclosure, but should not cover persons who are engaged in ordinary-course business communications with the issuer, or interfere with disclosures to the media or communications to government agencies.” *Id.* at 51,720.

The SEC further explained:

While it is conceivable that a representative of a customer, supplier, strategic partner, news organization, or government agency could be a security holder of the issuer, it ordinarily would not be foreseeable for the issuer engaged in an ordinary-course business-related communication with that person to expect the person to buy or sell the issuer’s securities on the basis of the communication. Indeed, if such a person were to trade on the basis of material nonpublic information obtained in his or her representative capacity, the person likely would be liable under the misappropriation theory of insider trading.

Id. at 51,720 n.27. See generally *United States v. O’Hagan*, 521 U.S. 642, 660-66 (1997) (discussing possible liability arising from misappropriated inside information).

77. See 17 C.F.R. § 243.100(b)(2) (setting forth exemptions).

who owe a duty of trust or confidence to the issuer.⁷⁸ Second, an issuer can avoid Regulation FD scrutiny by securing an express agreement to maintain confidentiality of information disclosed.⁷⁹ Third, information disclosed to ratings agencies in the course of a securities rating is exempted.⁸⁰ Finally, Rule 100(b)(2) excludes from Regulation FD coverage information disclosed in connection with most offerings of securities registered under the Securities Act.⁸¹

78. See 17 C.F.R. § 243.100(b)(2)(i) (stating one exception). This exemption embodies the “temporary insider” concept set forth in *Dirks*. For a discussion of the “temporary insider” concept, see *supra* notes 33-35 and accompanying text.

79. See 17 C.F.R. § 243.100(b)(2)(ii) (setting forth exemption). The agreement must be express, but does not necessarily have to be written. See Selective Disclosure and Insider Trading, 65 Fed. Reg. at 51,720 n.28 (“[A]n express oral agreement will suffice.”). Furthermore, the agreement may be obtained after the disclosure has been made, so long as the recipient has not disclosed or traded on the basis of the information received. See *id.* (explaining rule). Consequently, if an issuer mistakenly reveals material nonpublic information, the issuer can avoid violating Regulation FD by obtaining from the recipient an express agreement to maintain confidentiality. See *id.*

Furthermore, although an issuer may have obtained a confidentiality agreement from only a single individual within a larger organization, the issuer is not treated as communicating the information to the entire organization. See *id.* at 51,720 n.29 (describing example of information disclosed to investment banker and explaining that information is not considered disclosed to other parts of that investment banker’s firm—for example analysts and other personnel involved with sales). On the other hand, obtaining such an agreement would not permit disclosure to others within the recipient’s organization. See *id.* (stating confidentiality agreement applicable only to recipient).

80. See 17 C.F.R. § 243.100(b)(2)(iii) (setting forth exemption). The Commission set forth two justifications for this exemption. See Selective Disclosure and Insider Trading, 65 Fed. Reg. at 51,720 (setting forth rationale). First, the Commission noted that it was not aware of any incidents of selective disclosure involving ratings agencies. See *id.* Second, it emphasized rating agencies’ “mission of public disclosure” with an objective to widely publicize the rating when complete. See *id.* Furthermore, it noted that the exemption for ratings agencies is available only when the agencies make their credit ratings “publicly available.” See *id.*

81. See 17 C.F.R. § 243.100(b)(2)(iv) (excluding from exemption registered shelf offerings under Rule 415(a)(1)(i)-(vi)). The disclosed information must relate to the registered offering for the exemption to apply. See 17 C.F.R. § 243.100(b)(2)(iv) (stating rule). For example, an issuer that discloses to analysts news of an upcoming merger can not rely upon this exemption solely because the issuer is concurrently engaged in a registered offering. See *id.*

The Proposed Regulation FD included disclosures made in connection with an offering of securities under the Securities Act. See Selective Disclosure and Insider Trading, 64 Fed. Reg. At 72,590, 72,598 (Dec. 28, 1999) (“For example, the [Proposed] Regulation FD would apply to statements made in a ‘roadshow’ for a reporting issuer’s offering. In that situation, if an issuer made oral selective disclosure of material information, [Proposed] Regulation FD would require the issuer also to make public disclosure of the same information.”). Critics expressed concern that disclosures required under Proposed Regulation FD would violate Section 5 of the Securities Act. See, e.g., American Bar Association E-mail, *supra* note 68 (“The concerns arise because a disclosure made to satisfy the requirements of Regulation FD may be deemed to be an ‘offer’ of the issuer’s securities for purposes of Section 5 of the Securities Act and the required dissemination may be a ‘prospectus.’”). As a result, the Commission chose to remove communications

B. *Required Disclosure*1. *Intentional Versus Non-Intentional Disclosures: Timing of Required Public Disclosure*

Regulation FD differentiates between disclosures made intentionally and disclosures made inadvertently.⁸² In the case of an intentional disclosure, Regulation FD requires that the issuer simultaneously make a public disclosure of the information.⁸³ A disclosure is “intentional” if the issuer or any person acting on behalf of the issuer “knows, or is reckless in not knowing, that the information being disclosed is both material and non-public.”⁸⁴ Regarding inadvertent, or non-intentional disclosures, Regula-

made in connection with registered offerings from Regulation FD’s purview. *See* Selective Disclosure and Insider Trading, 65 Fed. Reg. at 51,725 (“[W]e have determined that our concerns about selective disclosure . . . should not be addressed by overlaying Regulation FD onto the system of regulation provided by [the Securities] Act. The mandated disclosure regime and the civil liability provisions of the Securities Act reduce substantially any meaningful opportunity for . . . selective disclosure . . .”). Further, the Commission has defined when registered offerings are deemed to begin and end for purposes of Regulation FD. *See* 17 C.F.R. § 243.101(g) (2000) (setting forth beginning and end of underwritten and non-underwritten offerings). Conversely, unregistered offerings of securities are not exempt from Regulation FD. *See* Selective Disclosure and Insider Trading, 65 Fed. Reg. at 51,725 (“We believe that reporting companies making unregistered offerings should either publicly disclose the material information they disclose nonpublicly or . . . hav[e] those who receive it agree to maintain it in confidence.”). Consequently, if an issuer selectively discloses material nonpublic information during an unregistered offering, without obtaining a confidentiality agreement, the issuer will be required to make prompt public disclosure regardless of whether such disclosure would make unavailable the exemption under which the securities are being offered. *See id.* (advising that issuer consult with corporate counsel regarding possible consequences of selective disclosure).

82. *See* 17 C.F.R. § 243.100(a) (stating rule).

83. *See* 17 C.F.R. § 243(a)(1) (2000) (same). For a discussion of what constitutes public disclosure, *see infra* notes 87-90 and accompanying text.

84. 17 C.F.R. § 243.101(a) (defining “intentional”). The Commission stressed that the knowing/reckless standard applies to both the determination of materiality and whether the information was nonpublic. *See* Selective Disclosure and Insider Trading, 65 Fed. Reg. at 51,722 (noting that the context of a disclosure is relevant to the determination of whether an issuer was reckless in making materiality judgment); *see also* Selective Disclosure and Insider Trading, 65 Fed. Reg. at 51,726 n.90 (noting that existence of policy regarding selective disclosure, and issuer’s adherence thereto, are relevant in determining issuer’s intent).

The inclusion of reckless conduct in the Proposed Rule elicited a number of negative comments. *See, e.g.,* Corporate Counsel E-mail, *supra* note 68 (“We are extremely concerned with this aspect of the proposal that would incorporate ‘recklessness’ into the definition of ‘intentional’ Recklessness as a legal concept has not offered clear guidance to corporations seeking to comply with prescribed standards of conduct.”); Corporate Secretaries E-mail, *supra* note 75 (“[We] worry that ‘reckless in not knowing’ is susceptible of [sic] being interpreted with twenty-twenty hindsight as something more akin to ‘negligent in not knowing.’”). Despite the comments, the Commission adopted the recklessness standard in the final version of Regulation FD. *See* 17 C.F.R. § 243.101(a) (stating recklessness standard); *see also* Selective Disclosure and Insider Trading, 65 Fed. Reg. at 51,722 (“Since recklessness suffices to meet the mental state requirement even for purposes of the

tion FD requires prompt public disclosure.⁸⁵ Failure to make the required disclosure can subject the issuer and/or the person responsible for the disclosure to various administrative penalties.⁸⁶

2. "Public Disclosure"

Regulation FD takes a very flexible approach to what constitutes a sufficient "public disclosure."⁸⁷ It allows issuers to make public disclosures for purposes of Regulation FD by filing or furnishing⁸⁸ a report on Form

antifraud provisions, we believe it is appropriate to retain recklessness in Regulation FD's definition of 'intentional' as well.") (footnote omitted).

85. See 17 C.F.R. § 243.100(a)(2) (stating rule). "Promptly" is defined as: as soon as reasonably practicable (but in no event after the later of 24 hours or the commencement of the next day's trading on the New York Stock Exchange) after a senior official of the issuer . . . learns that there has been a non-intentional disclosure by the issuer or person acting on behalf of the issuer of information that the senior official knows, or is reckless in not knowing, is both material and nonpublic.

17 C.F.R. § 243.101(d).

Presumably, the definition would include not only situations where the issuer learns of a disclosure, but also instances where the issuer is reckless in not learning of a disclosure; or intentionally avoids learning of the disclosure. See *Selective Disclosure and Insider Trading*, 65 Fed. Reg. at 51,723 (stressing the practical application of Regulation FD to prevent issuers from sidestepping their Regulation FD obligations). The Commission received a variety of opinions from commenters concerning the twenty-four hour time limitation. Compare E-mail from Gretchen Sprigg Wisehart, to Jonathan G. Katz, Secretary, SEC (Apr. 28, 2000), at <http://www.sec.gov/rules/proposed/s73199/wisehar1.htm> (agreeing with twenty-four hour standard), with Corporate Secretaries E-mail, *supra* note 75 (finding twenty-four hour period too short), and Corporate Counsel E-mail, *supra* note 68 (stating that time period prescribed was too specific).

86. For discussion of the liability that results from violating Regulation FD, see *infra* notes 93-95 and accompanying text. Note, however, that under Rule 103, failure to make a disclosure under Regulation FD will neither render the issuer ineligible for short form registration on Form S-2 and S-3, nor will it invalidate resales under Rule 144. See 17 C.F.R. § 243.103 (2000); see also *Selective Disclosure and Insider Trading*, 65 Fed. Reg. at 51,725-26 ("[T]he purpose [of Regulation FD] is not well served by negatively affecting a company's ability to access the capital markets. Nor is it well served by penalizing the shareholders or employees of the company.").

87. See *Selective Disclosure and Insider Trading*, 65 Fed. Reg. at 51,723 (describing Proposed Regulation FD as providing "considerable flexibility").

88. See *id.* at 51,723 (discussing alternatives under Regulation FD's public disclosure requirement). Regulation FD offers two alternatives. First, an issuer may choose to "file" a report under Item 5 of Form 8-K. If so, the information provided will be subject to: (1) liability under Section 18 of the Exchange Act; (2) automatic incorporation by reference into the issuer's Securities Act registration statements, thereby subject to liability under Section 11 and Section 12(a)(2) of the Securities Act; and (3) the antifraud provisions of the federal securities laws. See *id.* Alternatively, the issuer may choose to "furnish" a report under Item 9 of Form 8-K that will not be deemed "filed." See *id.* Information "furnished" is not subject to liability under Section 11 of the Securities Act or Section 18 of the Exchange Act, but remains subject to the antifraud provisions of the federal securities laws. See *id.*

8-K⁸⁹ or by disseminating the information “through another method (or combination of methods) of disclosure that is reasonably designed to provide broad, non-exclusionary distribution of the information to the public.”⁹⁰

89. See Selective Disclosure and Insider Trading, 64 Fed. Reg. 72,590, 72,596 (Dec. 24, 1999) (proposing new Item 10 to Form 8-K). Many commenters expressed concern that a separate Item 10 filing would be construed as an admission on behalf of the issuer regarding the materiality of the information disclosed. See, e.g., Corporate Counsel E-mail, *supra* note 68 (“[A] new Item 10 could be used as an admission of materiality by the plaintiffs’ bar to the detriment of an issuer in other contexts, [for instance] a fraud on the market suit for delayed disclosure.”); Corporate Secretaries E-mail, *supra* note 75 (same); Cleary E-mail, *supra* note 71 (“We do not believe this change to Form 8-K would be necessary or helpful.”); E-mail from Bonnie Burdett Dennis, Chairman of the Board, and Louis M. Thompson, Jr., President & CEO, National Investor Relations Institute, to Jonathan G. Katz, Secretary, Securities and Exchange Commission (Apr. 11, 2000), at <http://www.sec.gov/rules/proposed/s73199/dennis1.htm> (“[We believe] that the proposed Item 10 is not necessary and could pose problems . . .”). Consequently, the Commission expressly provided in the Final Rule Release that the materiality of information filed or furnished on Form 8-K, for the purpose of satisfying Regulation FD, will not be deemed admitted simply because of the filing. See Selective Disclosure and Insider Trading, 65 Fed. Reg. at 51,723 (discussing effect of Form 8-K filing or furnishing).

90. 17 C.F.R. § 243.101(e) (2000) (defining “public disclosure”); see also Selective Disclosure and Insider Trading, 65 Fed. Reg. at 51,723-24 (providing guidance as to acceptable methods of public disclosure). Such methods include widely distributed press releases and conference calls that the public is able to attend (either in person or by means of a telephone or the Internet), provided, however, that the public is given adequate notice of the disclosure. See 65 Fed. Reg. at 51,723-24 (emphasizing that sufficiency of methods will depend upon particular circumstances of individual issuers). The Commission, however, noted that because many investors do not have access to the Internet, a posting upon the issuer website, alone, would in most cases be insufficient. See *id.* (“As technology evolves . . . some issuers . . . could use such a method.”).

In the Final Regulation FD release, the Commission offered a model for disclosure of material information. See *id.* at 51,724. The Commission stated:

By following these steps, an issuer can use the press release to provide the initial broad distribution of the information, and then discuss its release with analysts in the subsequent conference call, without fear that if it should disclose additional material details related to the original disclosure it will be engaging in a selective disclosure of material information.

Id.

The Commission suggested the issuer first issue a press release through “regular channels.” See *id.* (explaining model for disclosure). Second, the issuer should give notice to the general public of a conference call scheduled to discuss the information. See *id.* Such notice should include instructions regarding accessing the call. See *id.* Finally, the issuer should hold the conference call, providing access to the general public. See *id.* (same). But see *id.* at 51,724 n.71 (“Giving the public the opportunity to listen to the call does not also require that the issuer give all members of the public the opportunity to ask questions.”).

Whether an issuer’s method of disclosure is “reasonably” designed to produce broad, non-discretionary dissemination of information depends upon “all the relevant facts and circumstances.” *Id.* at 51,724. This includes whether the issuer’s press releases are routinely carried by major business wire services and whether the method chosen constitutes a deviation from the issuer’s prior practice of distributing information. See *id.*

3. *Interaction with Liability Under the Federal Securities Law*

Regulation FD creates duties of disclosure under Sections 13(a) and 15(d) of the Exchange Act, as well as Section 30 of the Investment Company Act.⁹¹ It does not, however, create duties under the antifraud provisions of the federal securities laws or create private rights of action against noncompliant issuers.⁹² Issuers who violate Regulation FD are “subject to an SEC enforcement action alleging violations of Section 13(a) or 15(d) of the Exchange Act . . . and Regulation FD.”⁹³ The SEC can choose to bring either an administrative action seeking a cease-and-desist order or a civil action seeking an injunction and/or civil monetary penalties.⁹⁴ Also, in some instances, the individual responsible for the disclosure may be subject to a separate enforcement action.⁹⁵

IV. REGULATION FD: MARKET ANALYSIS AND CONSIDERATIONS OF FAIRNESS

A. *The Efficient Capital Market Hypothesis, Noise and Regulation FD*

1. *Regulation FD and the Efficient Capital Market Hypothesis*

To assess the probable impact of the Commission’s adoption of Regulation FD, it is helpful to pose the question in light of established theories relating to the market and market participant behavior.⁹⁶

91. See Selective Disclosure and Insider Trading, 65 Fed. Reg. at 51,726 (discussing liability issues surrounding Regulation FD).

92. See 17 C.F.R. § 243.102 (2000) (“No failure to make a public disclosure required solely by § 243.100 shall be deemed to be a violation of Rule 10b-5” (emphasis added)); see also Selective Disclosure and Insider Trading, 65 Fed. Reg. at 51,726 (“Accordingly, private plaintiffs cannot rely on an issuer’s violation of Regulation FD as a basis for a private action alleging Rule 10b-5 violations.”). Furthermore, focusing on the “required solely by” language of Rule 102, the Commission has stressed that Regulation FD “does not affect any existing grounds for [imposing] liability under Rule 10b-5.” Selective Disclosure and Insider Trading, 65 Fed. Reg. at 51,726. The Commission set forth four examples. First, 10b-5 liability could be imposed for selective disclosure made under circumstances that meet the *Dirks* “personal benefit” test. See *id.* Second, failure to make a disclosure may constitute a breach of duty under the “duty to correct” or the “duty to update” theory. See *id.* Third, extensive involvement with an analyst can subject the issuer to liability under the “entanglement” theory. See *id.* Fourth, Regulation FD does not provide protection from Rule 10b-5 liability when a disclosure made pursuant to Regulation FD either contains false or misleading information, or omits material information. See *id.*

93. Selective Disclosure and Insider Trading, 65 Fed. Reg. at 51,726.

94. See *id.* (describing possible courses of action).

95. See *id.* (stating that such individuals could be held responsible “either as ‘a cause of’ the violation in a cease-and-desist proceeding, or as an aider and abettor of the violation in an injunctive action.” (footnotes omitted)); see also *id.* at 51,726 n.91 (“A failure to file . . . will be considered a violation for as long as the failure continues; in our enforcement actions, we likely will seek more severe sanctions for violations that continue for a longer period of time.”).

96. For a discussion of the Efficient Capital Markets Hypothesis (“ECMH”), see *infra* notes 97-104 and accompanying text. The following descriptions of the

One of the most developed theories concerning the manner in which capital markets react to regulatory, and thereby informational, changes is the Efficient Capital Markets Hypothesis (the "ECMH").⁹⁷ Generally, the ECMH states that efficient markets value securities at a level that reflects publicly available information regarding those securities, even if not all market participants have access to the information.⁹⁸ Furthermore, an efficient market impounds new information regarding a security into the security's price so quickly that individual buyers and sellers gain no advantage by possessing the information.⁹⁹

Since its conception, the ECMH has been parsed into three discrete categories of market efficiency: the "weak form," the "semi-strong form" and the "strong form."¹⁰⁰ First, the market is efficient in the weak form when the price of a security reflects all information previously impounded into the security's price.¹⁰¹ If so, investors cannot predict a securities future price by looking at previous pricing information. Second, the semi-strong form of market efficiency occurs when security prices include all information publicly available.¹⁰² Third, the market is efficient in the strong form when prices embody all information concerning a security,

Efficient Capital Markets Hypothesis and the Noise Theory are not intended to be exhaustive recantations of each theory's intricacies. However, recitation of the principal concepts of each provides an amiable structure in which to assess Regulation FD's probable impact.

97. See JAMES D. COX ET AL., *SECURITIES REGULATION: CASES AND MATERIALS* 31-38 (2d ed. 1997) (discussing ECMH). The ECMH has been used as the basis for administrative policy and judicial decisions. See, e.g., Proposed Rulemaking to Implement the Integrated Disclosure System, Securities Act Release Nos. 6331-38, [1981-1982 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 83,016, at 84,479 (Aug. 6, 1981) ("Proposed Form S-3 relies on the efficient market theory . . ."); *Wielgos v. Commw. Edison Co.*, 892 F.2d 509, 510 (7th Cir. 1989) ("The Securities and Exchange Commission believes that markets correctly value the securities of well-foiled firms, so that new sales may rely on information that has been digested and expressed in the security's price."); see also Michael C. Jensen, *Some Anomalous Evidence Regarding Market Efficiency*, 6 J. FIN. ECON. 95, 95 (1978) ("[T]here is no other proposition in economics which has more empirical evidence supporting it than the efficient market hypothesis.").

98. See Ronald J. Gilson & Reinier H. Kraakman, *The Mechanisms of Market Efficiency*, 70 VA. L. REV. 549, 552-54 (1984). "Information" has been defined broadly as "data that has the capacity to alter one's beliefs about the world or, in our more limited context, one's beliefs about the appropriate price of an asset." *Id.* at 561.

99. See Gilson & Kraakman, *supra* note 98, at 555 ("[A]vailable information" does not support profitable trading strategies or arbitrage opportunities.").

100. See Eugene Fama, *Efficient Capital Markets: A Review of Theory and Empirical Work*, 25 J. FIN. 383 (1970) (discussing subsets of efficient capital markets hypothesis).

101. See COX ET AL., *supra* note 97, at 32-33 (describing weak form market efficiency).

102. See *id.* at 33 (same). The semi-strong form is considered to be the most validated of the three variations. See Donald C. Langevoort, *Theories, Assumptions, and Securities Regulation: Market Efficiency Revisited*, 140 U. PA. L. REV. 851, 852 n.7 (1992) (describing Fama's three-part typology of efficiency testing).

“whether that information is publicly available or not.”¹⁰³ Although a number of studies have demonstrated that markets respond efficiently to a wide variety of information, few have shown the cause for such efficiency.¹⁰⁴

In 1984, Ronald J. Gilson and Reinier H. Kraakman identified four models of market mechanisms that can cause capital markets to operate efficiently.¹⁰⁵ These mechanisms are referred to as “universally informed trading,”¹⁰⁶ “professionally informed trading,”¹⁰⁷ “derivatively informed

103. See COX ET AL., *supra* note 97, at 33 (describing strong form of market efficiency).

104. See Fama, *supra* note 100, at 404-09 (reviewing empirical tests); see also Gilson & Kraakman, *supra* note 98, at 551-52 (stating that research demonstrating market efficiency has “outpaced efforts to explain the phenomenon,” and consequently, “legal users of the ECMH literature have been . . . confronted with a body of empirical evidence in search of a causative theory”). Note, however, that much of the empirical research supporting the ECMH has been challenged by behavioral researchers who argue that the ECMH is based upon the flawed assumption that investors act rationally when trading. See generally Langevoort, *supra* note 102, at 858-61 (describing laboratory tests that have demonstrated investors do not act rationally when trading). For a discussion of this research, see *infra* notes 137-38 and accompanying text.

105. See Gilson & Kraakman, *supra* note 98, at 566 (identifying mechanisms). The authors set forth three features of the relationships amongst the identified mechanisms. First, the mechanisms ordinarily operate one at a time to instill new information into prices. See *id.* at 567 (setting forth “critical” features of relation among market mechanisms). Second, which mechanism will dominate depends upon how widely a piece of information is distributed. See *id.* Third, the speed at which each mechanism operates is a function of the breadth of the initial distribution. See *id.*

106. *Id.* at 568. Universally informed trading is the simplest form of efficiency mechanisms “in which all traders are, in fact, costlessly and simultaneously informed.” *Id.* This mechanism can be used to explain market efficiency in the context of “weak-form,” or “old,” information. *Id.* at 569. Because all traders are privy to the information, such information will be embodied in the security’s price, foreclosing any opportunity by individual investors to make a profit based upon the information. See *id.* at 568 (describing mechanism).

107. *Id.* at 569-72. The professionally informed trading mechanism embodies in prices information that is not universally disseminated among traders. See *id.* (describing mechanism). Such information is capitalized upon by market professionals, whose significant trading volume assures its rapid assimilation into price. See *id.* (“[R]apid price equilibration does not require widespread dissemination of information, but only a minority of knowledgeable traders who control a critical volume of trading activity.”). This mechanism, according to Gilson and Kraakman, accounts for the market’s efficiency in the semi-strong form. See *id.* at 572.

trading”¹⁰⁸ and “uninformed trading.”¹⁰⁹ Rather than being alternatives, all four mechanisms potentially operate with respect to a certain piece of information, with the identity and the efficiency of the exact mechanism dependent upon the breadth of the initial distribution of the information among traders.¹¹⁰ Gilson and Kraakman further propose that the breadth of the initial distribution is determined by the relative cost of providing such information; such costs are established in the “information market.”¹¹¹ As information costs decrease, the breadth of the initial distribution will increase.¹¹² Consequently, it follows, that as information costs decrease, the market becomes more efficient because more—and better—information is distributed and the increased distribution triggers a more efficient capital market mechanism.¹¹³

108. *Id.* at 572-79. This mechanism accounts for security prices reflecting information not generally available to the public. *See id.* (describing mechanism). As insiders capitalize upon nonpublic information, investors who lack the informational advantage can derive the nonpublic information two ways: trade decoding and price decoding. *See id.* at 573. Trade decoding occurs when uninformed traders directly observe the transactions of informed traders. *See id.* (defining term). For example, if an individual shareholder observes a member of the board selling a significant portion of the director’s interest in the company (based on negative nonpublic information), that shareholder will glean the negative information from the trade. Similarly, price decoding occurs when uninformed traders, without knowing the identity of those with an informational advantage, glean nonpublic information from changes in a security’s price and trading volume. *See id.* at 574-75 (defining term).

109. *Id.* at 579-88. The uninformed trading mechanism explains how prices come to reflect “soft” information—information such as forecasts and predictions, which by definition is unknown to all traders. *See id.* (describing mechanism). It states that traders form forecasts based upon secondary sources and individual biases that are unique to the individual. *See id.* at 579-81. As the number of traders, and consequently the number of individual forecasts, increases, individual biases cancel one another out, resulting in a single, “best-informed aggregate forecast.” *See id.* at 581 (“[U]nsystematic bias ‘washes out’ over trading . . .”). Note, however, that if individual erroneous biases become systematic or prevalent, this explanation of market efficiency begins to falter. *See Langevoort, supra* note 102, at 862 (“[S]uboptimal behavior that is common and predictable will not be of the random sort that . . . will cancel out.”).

110. *See Gilson & Kraakman, supra* note 98, at 592 (“[W]e expect the breadth of the initial distribution of information among traders to determine the relative efficiency of the market’s response.”).

111. *See id.* at 593 (“The lower the cost of particular information, the wider will be its distribution, the more effective will be the capital market mechanism operating to reflect it in prices, and the more efficient will be the market with respect to it.”).

112. *See id.* (stating “the information market . . . determines how information is initially distributed”).

113. *See id.* at 611 (“As information costs decline . . . the market becomes more efficient, both because the information is better and because its wider distribution triggers a more effective capital market mechanism.”).

Focusing on information costs identifies three categories of costs: “costs of acquisition.”¹¹⁴ “costs of processing”¹¹⁵ and “costs of verification.”¹¹⁶ If market efficiency is conceptualized as a function of information costs, market participants will—and do—strive to economize such information costs.¹¹⁷ Judged in light of this conceptualization of market efficiency, Regulation FD is advantageous because, while it may lead to an increase in processing costs, it will likely lead to significant decreases in acquisition and verification costs.

To begin, Regulation FD’s impact upon acquisition costs must be assessed from the standpoint of both issuers disseminating information and the information’s subsequent recipients.¹¹⁸ The Commission has estimated that the total costs of preparing the prescribed Form 8-K disclosures for all issuers affected by Regulation FD will be approximately \$49,562,500.¹¹⁹ Whether, and to what extent, these costs exceed the cur-

114. *See id.* at 594. Individual information acquisition costs differ depending on whether the individual is the originator of the information or a subsequent recipient. *See id.* (noting that costs will differ “in character”). Acquisition costs for an originator include all costs required to produce the information. *See id.* (noting examples of “discovery or innovation”). For the subsequent recipient, acquisition costs are the cost of obtaining the information from someone else. *See id.* (noting accomplishment regardless of “originator’s cooperation”).

115. *See id.* (“[P]rocessing costs are best exemplified by investment in human capital. Evaluation of information, whether self-produced or acquired from others, requires special skills . . . that can ordinarily be obtained only through investment in expensive professional training.”).

116. *See id.* Verification costs, like acquisition costs, depend upon the identity of the individual in question. For originators of information, verification costs include resources expended to determine the accuracy of existing information. *See id.* at 594-95 (separating verification costs categorically). For a subsequent recipient, most verification costs will be devoted to establishing the veracity of the originator. *See id.*

117. *See id.* at 597-605 (identifying attempts to reduce acquisition, processing and verification costs). Attempts to economize information costs have been established for each category of costs. Looking first to acquisition costs, the market economizes acquisition costs in a variety of ways. For example, acquisition costs are economized by cooperative programs whereby corporate insiders address a number of analysts at once, thereby reducing the acquisition costs incurred by individual analysts. *See id.* at 600 (setting forth example). Also, the mandatory disclosure scheme of the Exchange Act eliminates substantial acquisition costs by directing issuers to make specific disclosures. *See id.* at 601. Second, consider how the market economizes processing costs. Analysts themselves are the prime example of such canonization; through special training, analysts are able to process information more efficiently than individual investors. *See id.* at 601. Finally, the market economizes verification costs in a number of ways ranging from the use of professionals (such as lawyers and accountants) to verify information to advertising, and from agency approval (such as securities ratings) to imposition of civil and criminal penalties upon fraudulent producers of information. *See id.* at 602-05.

118. For a discussion of acquisition costs, see *supra* note 114.

119. *See* Selective Disclosure and Insider Trading, 65 Fed. Reg. 51,716, 51,731-33 (Aug. 24, 2000) (weighing costs and benefits of Regulation FD). The Commission based its estimate upon the anticipation that issuers will make one Regulation FD disclosure each quarter as well as one additional disclosure per year. *See id.* at

rent costs of selectively disclosing information cannot be accurately quantified. The estimated costs, however, can likely be significantly reduced by utilizing other permissible alternative methods of disclosure, such as press releases or webcasting over the Internet.¹²⁰ Furthermore, any increase in

51,732 n.154 (stating basis for estimates). The Commission concluded that issuers would incur approximately \$762.50 in costs to prepare each Form 8-K filing and that, while some issuers will make more than five annual Regulation FD disclosures, a “substantial number of issuers will make fewer than five [Regulation] FD disclosures annually.” *Id.* Many commenters criticized the Commission’s estimates as unfounded and baseless. *See, e.g.*, Letter from Bond Market Association, to Jonathan G. Katz, Secretary, Securities and Exchange Commission (Apr. 28, 2000) (available at Commission’s Public Reference Room) (finding Proposed Regulation FD’s estimate of legal involvement too low and stating that cost of compliance will be much greater than anticipated). *But see* Selective Disclosure and Insider Trading, 65 Fed. Reg. at 51,731-32 (revising estimates and finding estimates “appropriate”; “[W]e estimated the average number of hours . . . by contacting a number of law firms and other persons regularly involved in completing the form. We therefore believe that our estimate is appropriate.”).

The Commission addressed the potential costs of implementing a corporate policy relating to disclosure and found that such costs would not be substantial. *See id.* at 51,732. The Commission explained:

Many issuers already consult with in-house and/or outside counsel regarding their disclosure obligations under the federal securities laws. Moreover, as we have narrowed the definition of “persons acting on behalf of the issuer” to cover only those who regularly interact with securities market professionals and security holders, the issuer personnel whose disclosures will be covered by the regulation are those who are most likely to be well-versed in disclosure issues and practiced in making judgments on these issues. Further, to the extent that issuers already have policies in place to cover the types of disclosures those personnel can make, we expect the additional costs associated with compliance to be small.

Id.

120. *See* Selective Disclosure and Insider Trading, 65 Fed. Reg. at 51,732 (“[W]e anticipate that other methods of disclosure, such as press releases, may require less preparation time than a Form 8-K Moreover, if the costs of another method of disclosure are less than the costs of filing the Form 8-K, we presume issuers will choose another method of public disclosure.”). Proposed Regulation FD’s commenters disputed the costs associated with use of the Internet. *Compare* E-mail from Bradley Richardson, Co-Manager, The Nibelung Fund LLC, to Jonathan G. Katz, Secretary, Securities and Exchange Commission (Mar. 21, 2000, 21:07 EST), at <http://www.sec.gov/rules/proposed/s73199/richard1.txt> (“[T]he cost of full disclosure is quite minimal given the ever lower cost of using the Internet.”), *and* E-mail from Robert Bannon, CFA Director, Relations Net2000 Communications, to Jonathan G. Katz, Secretary, Securities and Exchange Commission (Apr. 28, 2000), at <http://www.sec.gov/rules/proposed/s73199/bannon1.txt> (“[T]here are several services that will make the audio from conference calls available to the general public over the Internet for no cost.”), *with* Letter from National Association of Real Estate Investment Trusts, to Jonathan G. Katz, Secretary, Securities and Exchange Commission (available at Commission’s Public Reference Room) (finding webcasts costly and stating use of new technologies entails additional costs).

Note, further, that Regulation FD does not require that the issuer incur any acquisition costs—only that the issuer incur those costs disseminating information on a non-selective basis. *See* Selective Disclosure and Insider Trading, 65 Fed. Reg. at 51,731 (stating that, as result of Regulation FD’s voluntary structure, exact estimate of number of issuers who will make Regulation FD disclosures is uncertain).

acquisition costs incurred by the issuer would pale in comparison to the decrease in acquisition costs that will be realized by analysts and individual investors.

First, analysts can expect their overall acquisition costs to decrease. Due to the intensive nature of acquiring information from issuers, an analyst is limited in the number of issuers he or she can follow.¹²¹ Regulation FD, however, economizes acquisition costs by granting that analyst access to the fruits of another analyst's labor.¹²² Consequently, although the cost of following the analyst's current group of issuers would likely remain constant, the analyst's costs in following additional issuers are reduced significantly, thereby allowing the analyst to follow additional issuers or decrease the cost of his or her services.¹²³

Second, individual investors will recognize a similar decrease in acquisition costs. Prior to Regulation FD, individual investors could discover the existence—and the likely significance—of selectively disclosed, material nonpublic information only by costly and speculative decoding of either known trades made by corporate insiders or price fluctuations in the issuer's securities.¹²⁴ Regulation FD's requirement of broad dissemination ensures that individual investor acquisition costs will be minimal, likely resulting in an increase in market participants.¹²⁵

Next, under Regulation FD, individual investors will incur additional processing costs, while analyst's processing costs will remain constant. Because Regulation FD embraces a materiality standard, issuers will likely make public disclosure of all borderline information, the materiality of which is subject to question.¹²⁶ As a result, individual investors will have to

121. See Lewis D. Solomon & Dan Wilke, *Securities Professionals and Rule 10b-5: Legal Standards, Industry Practices, Preventative Guidelines and Proposals for Reform*, 43 *FORDHAM L. REV.* 505, 512-19 (1975) (detailing analysts' role in capital markets).

122. See generally 17 C.F.R. § 243.100 (2000) (requiring broad public disclosure).

123. Commenters expressed concern that Regulation FD would chill communications between issuers and the investment community, making it more difficult for analysts to obtain information and thereby leading to an increase in analysts' acquisition costs. See, e.g., E-mail from American Electronics Association, Futures Industry Association, Institute of International Bankers, Securities Industry Association, The Bond Market Association, to Jonathan G. Katz, Secretary, Securities and Exchange Commission (Apr. 28, 2000) [hereinafter *Securities Industry*] (stating that "[Regulation FD] could prove to be a setback for the free flow of corporate information to the markets"); American Bar Association E-mail, *supra* note 68 (stating Commission "runs a significant risk of chilling the accelerating pace of information flow to the markets" by adopting Regulation FD).

124. See Gilson & Kraakman, *supra* note 98, at 569-72 (explaining process of "professionally informed trading").

125. See *Schlanger v. Four-Phase Sys. Inc.*, 555 F. Supp. 535, 538 (S.D.N.Y. 1982) (stating potential market participants not likely to enter capital market if they perceive it as stacked against them). The *Schlanger* court asked, "Who would knowingly roll the dice in a crooked crap game?" *Id.*

126. See, e.g., Corporate Counsel E-mail, *supra* note 68 ("No doubt there will be many instances where corporations will err on the safe side and file an 8-K

gauge the materiality of Regulation FD disclosures, as well as the significance of such information, thereby increasing individual processing costs. Conversely, an analyst's processing costs will remain constant; he or she will receive the same information, possibly in a different format.

Finally, Regulation FD will have a beneficial, if not benign, effect upon verification costs for issuers, analysts and individual investors. Regulation FD does not create an additional duty to update; therefore, issuers will not expend additional resources to ensure existing information is accurate.¹²⁷ Likewise, analysts' verification costs are likely to remain constant because the issuer remains the source of information.¹²⁸ On the other hand, verification costs of individual investors will drop precipitously because Regulation FD obviates the need for third party originators.¹²⁹

To summarize, a number of different capital market mechanisms operate to ensure market efficiency.¹³⁰ In any given situation, the identity and efficiency of the exact mechanism is dependent upon the breadth of the initial distribution of the information.¹³¹ Furthermore, the information costs of providing such information will determine the breadth of that initial distribution.¹³² Regulation FD results in a decrease in information costs and a concomitant increase in the breadth of the initial distribution, which will likely result in a more efficient capital market.

under Regulation FD, even though the materiality of the disclosure is unclear . . .").

127. See SECURITIES AND EXCHANGE COMMISSION, DIVISION OF CORPORATION FINANCE: MANUAL OF PUBLICLY AVAILABLE TELEPHONE INTERPRETATIONS (4th Supp. 2000), available at <http://www.sec.gov/interp/telephone/phonesupplement4.htm> [hereinafter TELEPHONE INTERPRETATIONS] (stating Regulation FD does not create duty or change existing law regarding duty to update).

128. See generally 17 C.F.R. § 243.100 (2000) (requiring broad public disclosure by issuers). Furthermore, any verification costs currently incurred by analysts in certifying the veracity of information received from other analysts will dissipate as analysts begin receiving such information directly from issuers. See Gilson & Kraakman, *supra* note 98, at 594-95 (stating principal verification cost of subsequent recipient is determining originator's truthfulness).

129. See *id.* (describing individual verification costs). Individual investors who previously received information from third parties, such as other investors, will no longer have to expend considerable resources assessing the veracity of that third party because the originator of the information will be the issuer, who remains subject to the antifraud provisions of the federal securities laws. See generally 17 C.F.R. § 240.10b-5 (2000) (setting forth general prohibition upon manipulative and deceptive devices).

130. See Gilson & Kraakman, *supra* note 98, at 568-87 (describing different mechanisms).

131. See *id.* at 592 (stating breadth of initial distribution determines relative "efficiency of market's response.").

132. See *id.* ("Understanding market efficiency . . . requires detailed analysis of the nature and dynamics of information costs.").

2. *Regulation FD and Market Efficiency in a "Noisy" Capital Marketplace*

Although the ECMH has served, and continues to serve, as a useful structure within which the market valuation of securities can be conceptualized, many scholars challenge whether the ECMH fully accounts for the values attributed by the market.¹³³ These scholars believe that "noise"¹³⁴ has a substantial impact upon trading behavior; an impact the ECMH trivializes.¹³⁵ To demonstrate the significant impact of noise, as well to expose the ECMH's trivialization of noise as unacceptable, noise theorists draw heavily upon research in the field of psychology, namely behavioral psychology.¹³⁶ Such research has shown that individuals often act in seemingly irrational and unpredictable ways, including the manner in which decisions are made under conditions of uncertainty, and the tendency to base decisions upon vivid and easily recalled information.¹³⁷ Individuals may also become overconfident in personal predictive abilities, value se-

133. See Langevoort, *supra* note 102, at 858-65 (surveying empirical research).

134. *Id.* at 854. "Noise" is defined as "pricing influences not associated with rational expectations about asset values." *Id.*

135. See generally Andrei Schleifer & Lawrence H. Summers, *The Noise Trader Approach to Finance*, J. ECON. PERSPS. 19 (1990) ("If the efficient markets hypothesis was a publicly traded security, its price would be enormously volatile . . .").

The ECMH states that irrational, or "noise," trading is counteracted two ways. First, the ECMH posits that noise trading that is based upon individual biases or mistakes will not effect the price-setting process because such trades will be canceled out by other noise trades, resulting in a market equilibrium that reflects the securities actual price. See Gilson & Kraakman, *supra* note 98, at 581 (increase in number of trades leads to "washing out" of individual biases). Second, if a security's price does move away from its actual value due to irrational trades, the discrepancy will be immediately capitalized upon by learned investors, thereby stabilizing the security's price. See Langevoort, *supra* note 102, at 863 (describing explanation as the "economist's trump card."). But see COX ET AL., *supra* note 97, at 42 (discussing risks involved in price decoding). Attempts to capitalize upon seemingly erroneous prices entails two risks: (1) the potential arbitrageur's prediction of appropriate value may be incorrect; and (2) a security whose price is currently out of line may remain out of line. See *id.*

In his thoughtful article entitled, *Theories, Assumptions, and Securities Regulation: Market Efficiency Revisited*, Donald Langevoort acknowledged these two ECMH responses are "well taken" and have possibly "served largely to immunize the [ECMH] from behavioral revisionism but for two sorts of observations." Langevoort, *supra* note 102 at 863 (emphasis added). First, Langevoort noted, there is evidence that market fads exist and that many, including securities professionals, do not believe in the ECMH. See *id.* Second, a substantial body of statistical data appears to contradict the ECMH. See *id.* (citing Stephen F. Leroy, *Efficient Capital Markets and Martingales*, 27 J. ECON. LIT. 1583, 1595-1603 (1989) (summarizing studies conducted through 1989)).

136. See Langevoort, *supra* note 102, at 857 (acknowledging "palpable tension" between ECMH and behavioral research).

137. See Kenneth J. Arrow, *Rationality of Self and Others in an Economic System*, 59 J. BUS. 3385, 3385 (1986) (finding that in situations of uncertainty and immediacy, individual choices not wholly based upon rational reflection); see also JUDGMENT UNDER UNCERTAINTY: HEURISTICS AND BIASES 416 (Daniel Kahneman et al. eds., 1982) (describing tendency of individual to discredit or ignore information inconsistent with individual's choice once made).

curities owned over securities available to be purchased, and pursue strategies based on the belief that securities are mispriced and engaged in seasonal trends.¹³⁸

Furthermore, noise theorists believe that the ECMH fails not only to take into account the fact that individual trading decisions are heavily influenced by trader interaction, but also that investors routinely underreact and overreact to corporate announcements.¹³⁹ Although the research concerning noise trading in the capital markets does call into question a number of premises upon which the ECMH resides—thus leaving the exact dynamics of market behavior unresolved—recognizing the beneficial effects of Regulation FD does not require a perfectly efficient market.¹⁴⁰

For example, consider the following hypothetical situation. Sellnow, Inc. (“Sellnow”) is a publicly traded company whose shareholders consist of both informed and uninformed investors.¹⁴¹ Sellnow selectively discloses to a handful of analysts that it has lost a supply contract currently accounting for ten percent of Sellnow’s revenues. The analysts then advise each of the informed investors of the information; a number of informed investors sell their holding’s of Sellnow securities; and the price of Sellnow drops. Next, the uninformed investors will “decode” the change in price and assume Sellnow has received bad news.¹⁴² Consequently, the

138. See Ward Edwards & Detlof von Winterfeldt, *Cognitive Illusions and Their Implications for the Law*, 59 S. CAL. L. REV. 225, 238-40 (1986) (describing experiment measuring overconfidence and concluding that persons are much more likely to be overconfident about difficult probability judgments than easy probability judgments). Edwards and Winterfeldt identified an “endowment effect” that caused consumers to “weight out-of-pocket losses more heavily than foregone gains of equal expected value.” *Id.* at 239-40; see also COX ET AL., *supra* note 97, at 41 (“[N]one of these observations is consistent with the view that stock prices are determined solely, or even significantly, by investor reaction to financial fundamentals related to the underlying investment.”). Whether or not the findings of behavioral research can be extended beyond the confines of the laboratory has been disputed. See, e.g., Robin M. Hogarth, *Beyond Discrete Biases: Functional and Dysfunctional Aspects of Judgmental Heuristics*, 90 PSYCH. BULL. 197, 213 (1981) (“[J]udgment and choice depend crucially upon the context in which they occur and the cognitive representation of that context.”).

139. See COX ET AL., *supra* note 97, at 41-42 (describing work of well respected noise theorist, Robert Shiller (citing Baruch Lev & Meiring de Viliers, *Stock Price Crashes and 10b-5 Damages: A Legal, Economic, and Policy Analysis*, 47 STAN. L. REV. 7, 12-22 (1994))).

140. See Langevoort, *supra* note 102, at 871 (“The prominence of [psychological research showing market noise] demonstrates that economists’ understanding of securities prices is still evolving and may take any number of diverse directions A substantial agenda for future research includes a sizeable cognitive psychology component. By no means is the efficient market theory dead”).

141. For purposes of this example, informed investors are those investors who have retained the services of a financial analyst following Sellnow, Inc. Furthermore, uninformed investors include all investors who have not retained a financial analyst, deciding instead to base their investment decisions solely upon information readily available in the financial media.

142. See Gilson & Kraakman, *supra* note 98, at 575 (describing logic of price decoding as “simple”). Under Gilson and Kraakman’s exposition of the mecha-

uninformed investors will sell as well, thereby exacerbating the drop in price. However, without knowing what has been selectively disclosed to the informed investors, the uninformed investors may continue to sell even when the current market price of the security is dramatically under its actual value.¹⁴³ In fact, the stock is likely to continue to fall until analysts instruct other informed investors to start buying.¹⁴⁴

Consider the same hypothetical under the disclosure regime created by Regulation FD. In order to make the proposed disclosure to the select group of analysts, Sellnow would be required to publicly disclose that information simultaneously to the uninformed investors.¹⁴⁵ Consequently, the uninformed investors will be able to evaluate the information announced instead of speculate as to its existence.¹⁴⁶ Presumably, any subsequent sale of Sellnow stock by the uninformed investors would be based upon a rational consideration of the company's disclosure, and the security's price would decrease to reflect those informed sales.¹⁴⁷

B. *Promoting Fairness and Taking the Chill Out of Corporate Communications*

The federal securities laws were enacted to promote not only an efficient operation of the capital market, but also to ensure that the securities markets are fair for all participants.¹⁴⁸ The Supreme Court has recog-

nism underlying the ECMH, the selective disclosure triggers the relatively inefficient "derivatively informed" trading mechanism. For a discussion of the "derivatively informed" trading mechanism, see *supra* note 108.

143. Enter the concept of market noise. Although the ECMH would suggest that the price of Sellnow stock would cease to decline once the bad news has been incorporated, it fails to account for the psychological phenomenon that noise theorists observe when uninformed investors jump on the bandwagon. For a discussion of the behavioral research addressing irrational trading behavior, see *supra* notes 137-38 and accompanying text.

144. Arguably, the price will return to a level that accurately reflects its actual value—the market thereby operating "efficiently." Regulation FD, however, accomplishes the same result more quickly and with less volatility.

145. See 17 C.F.R. § 243.100(a) (2000).

146. See Gilson & Kraakman, *supra* note 98, at 572-79 (discussing "trade decoding" and "price decoding"). Furthermore, the informed investors are not granted the opportunity to reap the benefits of the selectively disclosed information by selling their holdings before the price of Sellnow stock begins to fall.

147. See COX ET AL., *supra* note 97, at 33 (discussing semi-strong form of market efficiency). Regulation FD does not, of course, eliminate all noise from the marketplace. It is possible that uninformed traders will either fail to acquire the information or overestimate the potential impact of the information upon the company, thereby engaging in noise trading even under Regulation FD.

148. See Selective Disclosure and Insider Trading, 64 Fed. Reg. 72,590, 72,591 (Dec. 28, 1999) ("In enacting the mandatory disclosure system of the Exchange Act, Congress sought to promote disclosure of 'honest, complete, and correct information' to facilitate the operation of fair and efficient markets." (quoting S. REP. NO. 73-1455, at 68 (1934))); see also H.R. REP. NO. 73-1383, at 11 (1934) ("The idea of a free and open public market is built upon the theory that competing judgments of buyers and sellers as to the fair price of a security brings about a situation where the market price reflects as nearly as possible a just price . . ."). *But see* Broutas, *supra* note 1, at 1548 ("Congress's purpose in passing the '34 Act

nized that a necessary, beneficial effect of providing honest securities markets is to promote investor confidence in the market.¹⁴⁹ Regulation FD constitutes the Commission's attempt to maintain and increase investor confidence by eliminating a common practice which it believes undermines the market's integrity.¹⁵⁰ Furthermore, Regulation FD curtails the issuers' use of material nonpublic information as a commodity to ensure favorable analyst coverage, thus allowing analysts to express their honest opinions without fear of retribution.¹⁵¹ Finally, Regulation FD may have

was not to ensure that stock prices accurately reflect stocks' true values." (citing Lynn A. Stout, *The Unimportance of Being Efficient: An Economic Analysis of Stock Market Pricing and Securities Regulation*, 87 MICH. L. REV. 613, 699 (1988)).

149. See *United States v. O'Hagan*, 521 U.S. 642, 658 (1997) ("[I]nvestors likely would hesitate to venture their capital in a market where trading based on misappropriated nonpublic information is unchecked by law."); see also Opening Statement of Chairman Arthur Levitt at the Open Meeting on Regulation Fair Disclosure (News Supp., Aug. 10, 2000), at <http://www.sec.gov/news/extra/seldisal.htm> [hereinafter Arthur Levitt] (stating importance of informed capital markets). Chairmen Levitt stated:

High quality and timely information is the lifeblood of strong, vibrant markets. It is the very core of investor confidence If investors see a stock's price change dramatically—but are given access to critical market-moving information only much later—we risk nothing less than the public's faith and confidence in America's capital markets.

Arthur Levitt, *supra*.

150. See Arthur Levitt, *supra* note 149 ("Regulation FD would bring all investors, regardless of the size of their holdings, into the information loop—where they belong. To all of America's investors, it's well past time to say, 'Welcome to the neighborhood.'"). Not surprisingly, Proposed Regulation FD received overwhelmingly positive reviews from individual investors. See Fact Sheet: *Regulation Fair Disclosure and New Insider Trading Rules* (Aug. 10, 2000), at <http://www.sec.gov/news/extra/sdiscfaq.htm> ("The Proposing Release prompted . . . nearly 6,000 comment letters. The vast majority of the comments were from individual investors who urged . . . that the Commission adopt Regulation FD."); see also Commissioner Laura S. Unger, *Rethinking Disclosure in the Information Age: Can There Be Too Much of a Good Thing?* (June 26, 2000), at <http://www.sec.gov/news/speech/spch387.htm> [hereinafter *Rethinking Disclosure*] ("It is unusual for us to hear so much about our proposals from individual investors.").

For a listing of recent reports of selectively disclosed material, see *supra* note 9; see also E-mail from Gary Aguirre, to Jonathan G. Katz, Secretary, Securities and Exchange Commission (May 24, 2000, 10:27 EST), at <http://www.sec.gov/rules/proposed/s73199/aguirre1.txt> (individual investor incurring substantial losses in context of selective disclosure); E-mail from Doug Wilmsmeyer, to Jonathan G. Katz, Secretary, Securities and Exchange Commission (Apr. 28, 2000), (available at www.sec.gov (claiming current system "discriminatory")).

151. See *Selective Disclosure and Insider Trading*, 65 Fed. Reg. 51,716, 51,731 (Aug. 24, 2000) ("Analysts will continue to be able to use and benefit from superior diligence or acumen, without facing the prospect that other analysts will have a competitive edge solely because they say more favorable things about issuers.").

The use of inside information as a commodity is a concern that the Commission has repeatedly expressed. See, e.g., Arthur Levitt, *supra* note 149 ("[A]s Wall Street analysts play an increasingly visible role . . . some corporate management treat material information as a commodity."); *Selective Disclosure and Insider Trading*, 64 Fed. Reg. at 72,592 ("In this environment, analysts are likely to feel pressured to report favorably . . ."); *Selective Disclosure and Insider Trading*, 65 Fed. Reg. at 51,717 ("[A]nalysts who publish negative views of an issuer are some-

other beneficial effects, which include increased liquidity, low stock price volatility and decreased cost of capital.¹⁵²

The most common complaint received from issuers and securities professionals in response to the Proposed Regulation FD is that the rule would have a “chilling” effect upon corporate communications.¹⁵³ In turn, the SEC has identified five aspects of Final Regulation FD which it believes addresses the concern.¹⁵⁴ First, Regulation FD has been narrowed to include only communications between issuers and enumerated securities professionals, and securities holders under circumstances in which it is reasonably foreseeable that the security holder will trade upon the disclosed information.¹⁵⁵ The regulation no longer applies to all communications to persons outside the issuer, and excludes communications made to any person who expressly agrees to keep the disclosed informa-

times excluded by that issuer [from future selective disclosures].”); *see also* Amitabh Dugar & Siva Nathan, *Analysts' Research Reports: Caveat Emptor*, 5 J. INVESTING 13, 14 (1996) (“Retribution ranges from refusing the analyst’s calls for information, to barring the analyst from mailings, conference calls, and meetings, and even threats of legal action and physical harm.” (citations and footnote omitted)). *But see* E-mail from Lee Spencer, The Ad Hoc Working Group on Proposed Regulation FD and George A. Schieren, Vice President-Legal, SIA Compliance and Legal Division, Securities Industry Association, to Jonathan G. Katz, Secretary, Securities and Exchange Commission (Apr. 6, 2000), at <http://www.sec.gov/rules/proposed/s73199/spencer1.htm> (“Leveling the playing field for analysts, as among themselves and vis-a-vis the general public, will undermine the great advantages of the current system.”).

152. *See* NATIONAL INVESTOR RELATIONS INSTITUTE, STANDARDS OF PRACTICE FOR INVESTOR RELATIONS 7 (1st ed. Apr. 1998) (concluding liberal policies lead to increased analyst following, narrower consensus in earnings estimates, decreased price volatility and ultimately a lower cost of capital (citing Russell Lundholm & Mark Lang, *The Benefits of More Forthcoming Disclosure Practices* (Univ. of Mich. Sch. of Bus. Admin. 1994))); M.J. Fishman & K.M. Hagerty, *Insider Trading and the Efficiency of Stock Prices*, 23 RAND J. OF ECON. 106, 106 (1992) (finding that insider trading leads to decreased liquidity, increased volatility and increased cost of capital).

153. *See Rethinking Disclosure*, *supra* note 150 (“These commenters assert that determining materiality is too difficult and risky, making corporate officials less inclined to discuss important information at all.”).

Interestingly, the Commission also received complaints that adoption of Regulation FD would create too much disclosure, resulting in investor confusion. *See id.* (describing complaints as “ironic”). However, Regulation FD is consistent with the current trend of Internet-savvy investors demanding access to information, refusing to rely exclusively upon professional research. *See* Selective Disclosure and Insider Trading, 65 Fed. Reg. at 51,717 (“[The] online revolution has created a greater demand, expectation, and need for direct delivery of market information.”).

154. *See* Selective Disclosure and Insider Trading, 65 Fed. Reg. at 51,736 (listing modifications to Proposed Regulation FD).

155. *Compare* Selective Disclosure and Insider Trading, 64 Fed. Reg. at 72,594 (including communications to anyone outside the issuer), *with* 17 C.F.R. § 243.100(a) (2000) (including only communications with people described in § 243.100(b)(1)).

tion confidential.¹⁵⁶ Second, Regulation FD applies only to communications made by senior officials of the issuer and individuals who are in regular contact with securities professionals.¹⁵⁷ Third, the revised Regulation FD includes an express provision that eliminates any concern over private 10b-5 liability arising out of rule violations.¹⁵⁸ Fourth, regarding materiality judgments, Regulations FD's "knowing or reckless" conduct standard precludes the Commission from bringing enforcement actions for mistaken materiality judgments that the Commissions cannot establish were either intentional or reckless.¹⁵⁹ Finally, a violation of Regulation FD will not affect an issuer's eligibility to use short form registration or resell securities under Rule 144.¹⁶⁰

Those analysts that are dissatisfied with Regulation FD can be given three further assurances. First, Regulation FD is targeted at issuers—placing the responsibility of avoiding, and the risk of engaging in, selective disclosure on the issuer.¹⁶¹ Analysts can, however, in egregious situations, be found in violation of Regulation FD.¹⁶² Second, as Regulation FD es-

156. See 17 C.F.R. § 243.100(b)(2); TELEPHONE INTERPRETATIONS, *supra* note 127, at Question 10-11 (noting that confidentiality agreement must be express, however no additional agreement not to trade is necessary).

157. See 17 C.F.R. § 243.101 (2000) (defining "issuer" and "person acting on behalf of an issuer"). Furthermore, Regulation FD does not apply to communications made by a senior official of an issuer if the issuer has a policy expressly limiting who is authorized to speak and the insider making the communication is not authorized. See TELEPHONE INTERPRETATIONS, *supra* note 127 (stating that such communications "are made in breach of a duty of trust and confidence . . . and are not covered by Regulation FD").

158. See 17 C.F.R. § 243.102.

159. See 17 C.F.R. § 243.101(a) (noting an "intentional" disclosure occurs "when the person making the disclosure either knows, or is reckless in not knowing, that the information he or she is communicating is both material and nonpublic"); see also TELEPHONE INTERPRETATIONS, *supra* note 127, at Question 7 (restating that "seemingly inconsequential data" does not become material simply because skilled analyst is able to reveal material nonpublic information by combining such data with public information and analyst's knowledge of issuer and its industry); Remarks of Richard H. Walker, Director, Division of Enforcement, Regulation FD—An Enforcement Perspective (Nov. 1, 2000,) at <http://www.sec.gov/news/speech/spch415.htm> [hereinafter Enforcement Perspective E-mail] ("An issuer's incorrect determination that information is not material must represent an 'extreme departure' from standards of reasonable care . . .").

160. See 17 C.F.R. § 243.103 (2000).

161. See Enforcement Perspective E-mail, *supra* note 159 ("Regulation FD, first and foremost, is designed and intended to address issuer conduct.").

162. In a recent speech, the Director of the SEC's Division of Enforcement discussed a number of situations in which analysts may face liability. See Enforcement Perspective E-mail, *supra* note 159. For instance, analyst liability would attach if an analyst and an issuer conspire to exchange material nonpublic information. See *id.* (describing "suspect" behavior). Similarly, the Director admonished the use of abusive and threatening conduct by the analyst to procure such information and restated that judicial rules regarding insider trading remain applicable to issuer-analyst relationships. See *id.* ("It is okay to be persistent and dogged; it is not okay to be abusive and threatening."). Finally, the Director reminded analysts that inducing violations of Regulation FD will have a substantially negative impact upon

establishes a new market norm for issuer-analysts communications, the market will likely reward issuers with more liberal disclosure practices.¹⁶³ Finally, and most importantly, early indications show an increase in issuer disclosures since Regulation FD's adoption.¹⁶⁴

V. CONCLUSION

The SEC has adopted Regulation FD in response to what it views as a problematic practice of issuers selectively disclosing material nonpublic information to privileged members of the investment community.¹⁶⁵ Regulation FD effectively outlaws selective disclosure under its two-part scheme of broad concurrent disclosure for intentional communications and prompt dissemination following non-intentional disclosures.¹⁶⁶ Although Regulation FD seemingly eliminates analysts' incentives in ferreting out information, it may in practice result in increased market efficiency and increased disclosure, while furthering the purposes behind the federal securities laws.¹⁶⁷

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the business relationship between the issuer and analyst. *See id.* ("It is unlikely that an issuer led into a violation by an analyst will speak freely to that analyst again.").

163. For a discussion of the market's response to issuer disclosure practices, see *supra* note 152.

164. See Barbara C. Costanza, *Fair Disclosure Gets Companies to Talk* (Dec. 17, 2000), available at CBS.MarketWatch.com (stating that 700 companies have made public statements regarding earnings; 321 were warnings (compared to 439 companies and 204 warnings at this time last year)). Note, however, that the apparent increase in disclosures could simply constitute issuers publicizing information they would have otherwise selectively disclosed to analysts.

165. For a discussion of the issue presented by selective disclosure and judicial background prior to Regulation FD, see *supra* notes 13-56 and accompanying text.

166. For a discussion of the disclosure scheme created by Regulation FD, see *supra* notes 57-95 and accompanying text.

167. For a discussion of Regulation FD's impact upon market efficiency and fairness, see *supra* notes 96-164 and accompanying text.

